



**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 \$47,394,000 or 21.51% in 2013; by \$12,963,000 or 4.87% in 2014; and by \$34,797,000 or 12.59% in 2015.

Application 12-01-003
(Filed January 3, 2012)

**OPENING BRIEF OF
SAN JOSE WATER COMPANY**

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SUBJECT INDEX

	Page
I. SUMMARY OF SJWC’S POSITION ON THE PRINCIPAL ISSUES.....	1
II. PROCEDURAL BACKGROUND	3
III. ISSUES RELATING TO OPERATING REVENUES	5
A. The Estimated Number of Customers Should Reflect Expectations of Slow Economic Growth	5
B. The Adopted Estimates of Water Consumption by Customer Class Should Recognize the Continuing Policy Imperative to Pursue Water Conservation.....	6
C. The Adopted Sales Estimates Should Reflect the Effects of the Commission’s Response to the Parties’ Recommendations Regarding Recycled Water	9
D. Calculation of Operating Revenues at Present Rates Should Account for the Mountain District Uplift Charge Consistently With Disposition of the Six Mutuals Settlement.....	11
IV. ISSUES RELATING TO WATER SUPPLY PORTFOLIO.....	12
V. ISSUES RELATING TO COMPANY-WIDE EXPENSES	15
A. Forecast Methodologies.....	15
B. SJWC’s Payroll Expense Forecast Reflects Reasonable Cost Escalation Factors and Well-Justified Additions of New Employee Positions	17
1. SJWC properly based its forecast of payroll expense on the most current data, while DRA’s exclusion of various components of payroll expense was unjustified	18
2. The new positions included in SJWC’s payroll expense forecast are well justified.....	22
C. SJWC Has Fairly Estimated Test Year Transportation Expenses.....	24
1. Transportation – Labor	25
2. Transportation – Payroll Taxes.....	25
3. Transportation – Insurance	25
4. Transportation – Fuel.....	26

SUBJECT INDEX

	Page
5. Transportation – Depreciation	27
6. Transportation – Other	28
VI. ISSUES RELATING TO OPERATIONS AND MAINTENANCE.....	29
A. Purchased Services	29
1. SJWC justified incremental adjustments to baseline estimates for purchased O&M services, especially for Arc Flash assessment and IT projects.....	30
2. SJWC fully justified the expenses projected to be incurred to comply with additional water quality regulatory requirements	33
3. Water Quality Regulatory Fees are another source of additional costs that should be allowed	35
B. SJWC’s Estimates for the Several Elements of Operating Expenses Are Reasonable and Should Be Approved	37
1. Other Source of Supply.....	38
2. Purchased Power	38
3. Pump Tax	39
4. Other Pumping.....	39
5. Chemicals.....	40
6. Other Water Treatment expenses.....	41
7. Transmission and Distribution expenses	41
8. Customer Accounts.....	42
C. Differences Between the Parties’ Estimates of Maintenance Expenses Are Due to Factors Previously Addressed.....	43
1. Maintenance of Source of Supply plant.....	44
2. Maintenance of Pumping plant	44
3. Maintenance of Water Treatment plant	44

SUBJECT INDEX

	Page
4. Maintenance of Transmission and Distribution plant.....	45
VII. ISSUES RELATING TO ADMINISTRATIVE AND GENERAL EXPENSES	45
A. Estimates of Office Supplies Expenses Warrant Attention to Increasing Cost Trends Driven in Some Cases by Commission Policy Priorities.....	46
1. Utility Supplier Diversity program.....	46
2. Landscaping, Travel and Incidental; Bank Service Charges; and Other Office Supplies expenses.....	47
B. Brokers' Forecasts Provide the Most Reliable Basis for Estimating Test Year Property Insurance Costs	47
C. SJWC's Estimates for the Costs of Injuries & Damages Insurance Are Soundly Based.....	48
1. Workman's Compensation Insurance.....	48
2. Public Liability Insurance.....	49
D. SJWC's Estimate of Regulatory Commission Expense Properly Recognizes the Increasing Cost of Regulatory Proceedings and Should Be Approved	50
E. SJWC's Estimates of Outside Services Expenses Are Reasonable.....	51
1. Outside Services – Legal	52
2. Outside Services – Other	53
F. The Costs SJWC Includes in Its Forecasts of Dues and Memberships Expenses Are Appropriate for Recovery in Rates.....	53
1. Company dues	53
2. Employee dues.....	54
G. SJWC's Estimate of Rents Expense Is Reasonable.....	55
H. Transferred Expenses Is Properly Estimated Based on a Five-Year Average	55
I. SJWC's Estimates of Pensions and Benefits Costs Are Soundly Based and Should Be Approved.....	56

SUBJECT INDEX

	Page
1. Forecasting Methodology	56
2. Retirement Plans	57
3. Retirement Savings Plan	59
4. Employee Stock Purchase Plan.....	59
5. Unfunded Pensions	60
6. Post-retirement Benefits Other than Pensions (“PBOPs”).....	60
7. Life Insurance	61
8. Medical Insurance.....	62
9. Dental Insurance	62
10. Long-Term Disability Insurance.....	63
11. Other Employee Benefits.....	63
12. Health Savings Account expense.....	64
VIII. ISSUES RELATING TO TAX EXPENSES.....	65
A. Ad Valorem Taxes Are a Function of Utility Plant Investment.....	65
B. Payroll Taxes Vary With Estimates of Payroll Expense	65
C. Local Franchise Fees Are a Function of Adopted Revenues	66
D. SJWC Has Justified Its Treatment of Net Operating Losses and Related Deductions in Calculating Income Tax Expense for Regulatory Purposes.....	66
1. Ratemaking interest deduction.....	67
2. California Corporate Franchise Tax (depreciation)	67
3. Application of Net Operating Losses and the Domestic Production Activities Deduction	67
IX. ISSUES RELATING TO UTILITY PLANT IN SERVICE	71
A. The Modest Budget SJWC Proposes for Investments in Land Should Be Approved.....	72

SUBJECT INDEX

	Page
B. There Are No Issues Regarding Source of Supply Plant	73
C. The Replacement and Repair of Reservoirs and Tanks That Are at Issue Are Necessary and Justified	73
1. SJWC has justified replacing the tank of Koch Lane Station	74
2. Reconstruction of the reservoir roof structure at Almaden Valley Station is required	76
D. SJWC Has Demonstrated Its Need for the Investments in Pump Stations and Equipment That Are Contested by DRA	77
1. SJWC has fully justified the MCC replacements and pump relocations and additions proposed for several pumping stations	78
a. MCC replacement and pump relocation at Overlook Road Station	78
b. MCC addition and a second booster at Mireval Station	80
c. MCC replacement and pump relocation at Franciscan Station.....	82
d. An additional booster pump at Buena Vista Station.....	84
e. MCC replacement and addition of a booster pump at Miguelito Station	86
f. MCC replacement at Koch Station	87
2. SJWC has specifically justified the installation and costs of standby generators at all the sites opposed by DRA	88
3. SJWC has fully justified its planned investment in Pump Stations and Equipment and DRA’s criticisms of those projects do not stand up to scrutiny	91
E. SJWC’s Proposed Budgets for Distribution Plant Should Be Approved	92
1. The Commission should authorize SJWC to proceed with plans to construct mains during this GRC cycle for delivering recycled water	92
2. SJWC has shown the benefits of continuing to pursue a steady core program of 1% annual main replacements.....	97

SUBJECT INDEX

	Page
3. The budget for replacing services should match that for pipeline replacement	102
4. In setting a budget for new and replacement meters, SJWC agrees with DRA that the number of recycled water meters should be commensurate with plans to install recycled water mains, but SJWC’s forecasted cost to replace Sensus meters is reasonable and DRA’s adjustments are unwarranted.....	102
F. In the Area of Departmental Equipment, SJWC Has Justified Its Proposed Investments for the RIM Initiative and Other IT Projects.....	104
1. The RIM Initiative is a high priority project aimed to achieve a well-managed records and information repository that serves efficiency, safety, and customer service goals.....	105
2. Other IT Equipment investments will enhance the efficiency of SJWC’s operations.....	108
G. SJWC Has Justified Purchasing 12 Mobile Standby Generators	111
H. The Evidence Supports SJWC’s Proposed Budget for Vehicles.....	114
I. SJWC Has Proposed Two Green and Alternative Energy Projects That Will Benefit Customers While Reducing SJWC’s Need for Power From the Grid	115
1. The solar pV project at Williams Road Station will satisfy on-site power needs with a 13-year payback.....	117
2. The hydro-turbine project at Alum Rock turnout will convert otherwise wasted hydro-power into electric sales to PG&E	118
X. OTHER ISSUES RELATING TO RATE BASE.....	120
A. With Correction of an Error in the Salvage Rate, SJWC’s Proposed Depreciation Rate, Expense, and Reserve Are Properly Calculated	120
B. SJWC Has Calculated Its Allocation for Cash Working Capital in Full Compliance With Standard Practice U-16-W	122
XI. THE CONSERVATION PROGRAM EXPENSE PROJECTED BY SJWC WILL FUND AN EXPANDED SET OF CONSERVATION PROGRAMS SERVING THE GOALS OF THE WATER ACTION PLAN	126

SUBJECT INDEX

	Page
XII. THE EXPENSES RELATED TO NON-TARIFFED PRODUCTS AND SERVICES THAT DRA SEEKS TO DISALLOW ARE NON-INCREMENTAL AND SO ARE PROPERLY RECOVERABLE IN RATES	131
XIII. SJWC’S PROPOSED 3-TIER RATE DESIGN IS NOT REGRESSIVE AND SHOULD BE APPROVED TO ACCOMPANY A WRAM/MCBA	133
XIV. A WRAM/MCBA WILL ACHIEVE REVENUE DECOUPLING AND SO ELIMINATE SJWC’S DISINCENTIVE TO PROMOTE WATER CONSERVATION	138
XV. BALANCING AND MEMORANDUM ACCOUNTS.....	144
A. A Health Care Memorandum Account Is Appropriate in View of Current Uncertainty About Future Health Care Costs	144
B. An International Financial Reporting Standards Memorandum Account Will Address the Uncertain Impact of a New System of Accounting Standards	145
C. A Chromium VI Memorandum Account Is Justified in View of the Enormous Range of Costs That a Chromium VI Contamination Standard Could Entail.....	148
D. It Is Premature to Amortize SJWC’s Resolution L-411 Memorandum Account.....	150
E. The Commission Should Authorize Recovery of Balancing and Memorandum Account Balances as Stated in SJWC’s Rebuttal Testimony	151
XVI. CONCLUSION.....	152

TABLE OF AUTHORITIES

Page

CALIFORNIA PUBLIC UTILITIES COMMISSION CASES AND ORDERS

General Order 103-A	89
General Order 156.....	46, 47
<i>Investigation to Consider Policies to Achieve the Commission’s Conservation Objectives for Class A Water Utilities,</i>	
Decision 08-02-036.....	138
Decision 08-08-030.....	138
<i>Re Apple Valley Ranchos Water Company,</i>	
Decision 05-12-020.....	125
<i>Re California Water Service Company,</i>	
Decision 08-07-008.....	135
<i>Re California Water Service, et al. re Amortization of WRAM-Related Accounts,</i>	
Decision 12-04-048.....	139, 140, 143
<i>Re San Jose Water Company,</i>	
Decision 09-11-032.....	23, 93, 97, 118, 119
<i>Re Valencia Water Company,</i>	
Decision 10-12-029.....	138
Resolution L-411, adopted April 14, 2011	68, 150
Resolution L-411A, adopted June 23, 2011.....	68, 69, 149, 150, 151
<i>Rulemaking to Consider Revisions to the General Rate Case Plan for Class A Water Companies, Decision 07-05-062.....</i>	3, 6, 16
<i>Rulemaking to Evaluate Existing Practices and Policies for Processing General Rate Cases and to Revise the General Rate Case Plan for Class A Water Companies, D.04-06-018.....</i>	16
<i>Rulemaking for Water and Sewer Utilities Re Affiliate Transactions and Use of Regulated Assets for Non-Tariffed Utility Services, Decision 11-10-034.....</i>	131

TABLE OF AUTHORITIES

Page

FEDERAL STATUTES

Affordable Care Act.....	142, 143
Internal Revenue Code	
Section 199.....	67, 68, 70
Section 199(a)(1)	70
Tax Relief Act of 2010	67, 68, 69, 70, 148

CALIFORNIA STATUTES

SBx7-7 (2009).....	7
--------------------	---

CALIFORNIA PUBLIC UTILITIES COMMISSION RULES AND RULINGS

Assigned Commissioner’s Ruling and Scoping Memo, A.12-01-003, March 15, 2012	4
Division of Water and Audits, Standard Practice for Determination of Straight-Line Remaining Life Depreciation Accruals, Standard Practice U-4-W	120
Division of Water and Audits, Standard Practice for Determination of Working Cash, Standard Practice U-16-W	122, 123, 124, 125, 126
Rules of Practice and Procedure	
Rule 13.11	1
Uniform System of Accounts for Class A Water Utilities, effective January 1, 1955, as amended	122
Water Action Plan, adopted December 15, 2005	8, 20, 115, 116, 129, 134
2010 Water Action Plan, adopted October 2010	7, 20, 93, 96, 116, 117, 131

OTHER AUTHORITIES

Gleick, P., <i>Basic Water Requirements for Human Activities: Meeting Basic Needs</i> , International WaterResources Association, 1996	136
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Application 12-01-003
(Filed January 3, 2012)

**OPENING BRIEF OF
SAN JOSE WATER COMPANY**

In accordance with Rule 13.11 of the Commission’s Rules of Practice and Procedure and the schedule established by Administrative Law Judge (“ALJ”) Seaneen Wilson, San Jose Water Company (“SJWC” or “the Company”), applicant in the above-captioned proceeding, hereby submits its opening brief, addressing all contested issues presented in this general rate case (“GRC”). The Division of Ratepayer Advocates (“DRA”) and a group of six mutual water companies taking service from SJWC in its Mountain District (the “Six Mutuals”) are the only other parties that have actively participated in this proceeding.

I.

SUMMARY OF SJWC’S POSITION ON THE PRINCIPAL ISSUES

Many issues, large and small, are presented in the testimony and exhibits of SJWC and DRA. In the present opening brief, SJWC has sought to present the key elements of the evidentiary record in a concise but reasonably thorough fashion for the ALJ’s and the Commission’s review and consideration, along with references to the exhibits and testimony where further detail needs to be explored. In this summary, SJWC will not seek to address all

the important issues, but rather to note a few recurring and pervasive differences in the positions and perspectives of the parties, to which decision makers should be attentive as they seek to resolve particular issues.

The most fundamental dividing line that runs through the parties' positions in this proceeding is the gap between long-term policy commitments and a short-term focus on minimizing costs. This division is at the heart of a broad range of disputed issues:

- State and Commission policies mandate vigorous promotion of water conservation, but limiting sales of a service heavily dependent on fixed cost investments necessarily means higher rates per unit sold. SJWC takes the water conservation policy into account in forecasting sales, proposing aggressive new conservation programs and recycled water investments, and offering a three-tier conservation rate design tied to implementing a proposed Water Revenue Adjustment Mechanism (“WRAM”). DRA, meanwhile, discounts conservation in its sales estimates, would disallow new conservation programs, recycled water projects, and the WRAM, and proposes rates that would shield small users from any impact of higher costs. Is water conservation still a policy goal of this Commission? That is the issue presented, front and center, in this GRC.
- Another of the Commission's key water policies is to support wise investment in utility infrastructure. For SJWC, an almost 150 year old company with a stable service area, that policy translates most importantly into a well-planned and prudent pipeline replacement program designed to maintain the replacement rate of 1% per year that the Commission authorized in SJWC's last GRC. For DRA, concerns about short-term cost impacts justifies slowing down the pace of pipe replacement, without evident concern for the future spike in pipeline failures that is sure to follow.
- Similar considerations justify SJWC's plans to repair or replace aging tanks and reservoirs and to replace superannuated Motor Control Centers (“MCCs”) that are

key components for several essential pumping stations, all projects to which DRA most often is opposed.

- SJWC's commitment and DRA's reluctance to implement important public policies and mandates also is evident in SJWC's proposal to add 23 new positions to its payroll, in addition to four new positions added during 2011, while DRA would allow funding for only three new positions over a four-year period. More stringent water quality standards require more monitoring, testing, and reporting and more employees to do that work. The same is true for new positions necessary to maintain high quality customer service, safe and effective maintenance and operation of utility plant, effective conservation programs, and the ability to respond to other regulatory requirements and initiatives.

II.

PROCEDURAL BACKGROUND

SJWC filed this GRC application (the "Application") on January 3, 2012, seeking Commission authorization to increase rates for the Test Year 2013 and Escalation Years 2014¹ and 2015, and to make investments and accounting changes as specified therein. DRA filed a protest to the Application on February 6, 2012, with another protest late-filed by the Six Mutuals on February 13, 2012, by ruling of ALJ Seaneen Wilson at the prehearing conference convened on the same date.

Also during the prehearing conference, ALJ Wilson granted party status to the Six Mutuals and the parties addressed other procedural issues, agreed to limit the scope of the proceeding to exclude any issues related to the Montevina Water Treatment Plant upgrades, and

¹ In accordance with the applicable Rate Case Plan for Class A Water Utilities, 2014 is a second test year with respect to the estimation of Utility Plant in Service, Depreciation, and other accounts relevant to the calculation of rate base but is an escalation year with respect to revenue and expense calculations. *See, Re Revisions to the Rate Case Plan for Water Utilities*, D.07-05-062, App. A, at A-19.

broadly outlined their position on other issues. The March 15, 2012 Assigned Commissioner's Ruling and Scoping Memo outlined the issues and set the scope of the proceeding and the procedural schedule. Following discovery, DRA and the Six Mutuals served their testimony on April 30, 2012, to which SJWC responded in rebuttal testimony served May 21, 2012.

The parties participated in a noticed settlement conference on May 24, 2012. Among the issues discussed during settlement negotiations were those related to SJWC's rate design and proposed rates for the Company's Mountain District. Over the course of weeks, the parties discussed and resolved all the issues of concern to the Six Mutuals. SJWC and the Six Mutuals drafted a Settlement Agreement, which included revisions to Tariff Schedule 1C, and submitted the Settlement Agreement by joint motion of the Six Mutuals and SJWC for approval of the Commission on June 5, 2012. Although the Settlement Agreement was not an all-party settlement, the only other party to this proceeding, DRA, actively participated in the settlement process and did not oppose its terms.

Evidentiary hearings were held on June 4 to 6 and concluded on June 11th. As DRA and SJWC were unable to reach a settlement in this proceeding, the hearings addressed a broad range of issues, including especially issues relating to: (1) SJWC's forecasted sales and operating revenues; (2) payroll, pensions and benefits, and other operating, maintenance, and administrative expenses; (3) calculation of SJWC's income taxes and other tax expenses; (4) proposed investments in reservoirs, tanks, pump stations, and standby generators; (5) SJWC's proposed pipeline replacement program; (6) SJWC's plans to invest in recycled water distribution plant and green energy projects; (7) proposed funding for expanded conservation programs; (8) conservation oriented rate design; (9) the Company's proposal to decouple revenue from sales by implementing a Water Revenue Adjustment Mechanism ("WRAM") and a Modified Cost Balancing Account ("MCBA"), and (10) other balancing

account and memorandum account issues. These also are the principal topics that SJWC addresses in this opening brief.

III.

ISSUES RELATING TO OPERATING REVENUES

A. The Estimated Number of Customers Should Reflect Expectations of Slow Economic Growth.

SJWC estimated the customer additions for the Residential and Business classes using the three year (2009-2011) average increase and estimated the Other customer additions using a two year (2010-2011) average increase. SJWC's Test Year 2013 customer forecasts are 196,962, 20,258, and 111 for the Residential, Business, and Other customer classes respectively. Exhibit SJW-2A, WP 7-3A, WP 7-12A.

DRA recommends the use of a five-year average to avoid having forecasts biased by the 2008-2009 economic recession and recommends a five-year average for the Other customer class for consistency and to capture wider fluctuations in recorded data. DRA's Test Year 2013 customer forecasts are 197,345, 20,344, and 130 for the Residential, Business, and Other customer classes respectively. Exhibit DRA-1, ch. 2 (Rauschmeier), at 3.

In rebuttal testimony SJWC challenged DRA's use of a five-year average for these customer classes. By including the year 2007 outlier, DRA produces forecasts that are seriously biased by the stronger economy prevalent before the 2008-2009 economic recession. DRA's five-year period would include the two "bubble years" of 2006 and 2007, as well as the recession years of 2008 and 2009. DRA therefore proposes that in 2010 the San Jose economy would have recovered to an average historic level of growth (including the bubble years), rather than the much slower level that we have experienced recently. Ben Bernanke, Chairman of the Federal Reserve Bank, has announced that he expects the Bank to keep interest rates at their

current low levels through to the end of 2014. Clearly, contrary to DRA's assertions, Chairman Bernanke expects that there will be no recovery to "normal levels" of economic activity through 2014. SJWC's recommended 3-year average percentage change from 2009-2011 provides a steadily increasing customer forecast that accounts for the slow economic recovery. Therefore, this customer forecast is a more appropriate reflection of the underlying weakness of the economy that discounts the stronger "bubble years" of the pre-recession economy that drove customer growth from 2006 to 2007. Exhibit SJW-10, ch. 5 (Jensen), at 7-8.

B. The Adopted Estimates of Water Consumption by Customer Class Should Recognize the Continuing Policy Imperative to Pursue Water Conservation.

As provided for in the Rate Case Plan for Class A Water Utilities,² SJWC estimates water consumption for residential and business classes on a per customer basis utilizing the "New Committee Method." Following the Rate Case Plan guidelines for other sales categories, including Industrial, Public Authority, Resale, and Other classes, the calculated average annual sales by customer class were used to forecast future sales. Exhibit SJW-1, ch. 6 (Illingworth), at 6. These sales estimates are then reduced by 1.5% a year based on SJWC's ongoing, and proposed, conservation measures as well as the Commission ordered conservation goal of "a 1-2% annual reduction in consumption per service connection and customer class in one hundred cubic feet." *Id.* at 17.

In coordination with DRA's recommendations to continue conservation spending at current levels and to disallow SJWC's proposed expansion of conservation spending (discussed in Section XI below) DRA removes the additional conservation adjustment from the water sales forecasts. Exhibit DRA-1, ch. 2 (Rauschmeier), at 2. DRA's position indulges in

² *Re Revisions to the Rate Case Plan for Water Utilities*, D.07-05-062, App. A.

inappropriate short term thinking that ignores both State of California and Commission policies promoting water conservation and overlooks the effects of conservation programs that are already being pursued. DRA appears to have ignored the California Legislature's passage and Governor Schwarzenegger's signature of SBx7-7. The Public Utilities Commission's Legislative Summary for 2009 states that "(t)he intent of this bill is to reduce urban per capita water use by 20 percent by 2020." Further, the legislation requires that urban water utilities should achieve at least a 10 % reduction in urban per capita water use by 2015.

Thus, recent legislation requires that urban water utilities institute conservation programs so as to reduce per capita water use by approximately 2 % per year. There is no assurance that SJWC's current conservation program will suffice to achieve this legislative mandate. Indeed, much of the recent conservation may have been due to the drought and public appeals for short-term conservation. These savings may be transitory over the long run and may dissipate, when (or if) more plentiful water supplies return or the economy rebounds. In order to comply with the law, SJWC and the Commission need to support and reinforce customers' recent efforts with a long-term program. The only excuse for DRA to recommend that the Commission should not support SJWC's efforts to comply with state law would be if DRA could demonstrate that the law's goals could be achieved without the conservation program. DRA has not provided this demonstration. Exhibit SJW-10, ch. 4 (Illingworth), at 2.

DRA also has ignored Commission policies related to water conservation. In October 2010 the Commission adopted the revised and updated 2010 Water Action Plan. Two key objectives which that Plan retains from the original Water Action Plan adopted in December 2005 are to strengthen water conservation programs to a level comparable to those of energy utilities and to set rates that balance investment, conservation, and affordability. The 2010 Water Action Plan references the passage of SBx7-7 and recognizes its call for greater

conservation. As part of the Water Action Plan, the Commission decided that there is a need to establish utility financial incentive for greater conservation, with opportunities for higher earnings to result from successful conservation efforts. Further, the Water Action Plan discusses requiring utilities to achieve a 5 % reduction in use within the three-year rate case cycle. Exhibit SJW-10, ch. 4 (Illingworth), at 2.

In May of 2011 the Commission adopted a minimum conservation goal of a 1 to 2% annual reduction in consumption per service connection by each customer class for all Class A water utilities, including SJWC. Further, all Class A water utilities were ordered to provide annual conservation reporting for the Commission's use in tracking progress on these conservation goals. *See*, Exhibit SJW-1, ch. 6 (Illingworth), at 5.

Thus, DRA's proposal to defund SJWC's conservation program expansion is in direct opposition to the Commission's adopted policy of strengthening water conservation programs. Further, failure to recognize the need to further reduce per capita water usage is inconsistent with, and in fact, in opposition to Commission-adopted policy of requiring that the water utilities continue to increase the levels of conservation they achieve over the rate case cycle. Exhibit SJW-10, ch. 4 (Illingworth), at 3.

Moreover, the conservation adjustment applied in SJWC's sales estimates is not solely the result of the expansion to the conservation program proposed in this GRC. The standard statistical analysis only reflects an average trend in conservation over the last ten years and there are many reasons, including environmental and legal requirements, to believe that the local, regional, and statewide commitment to conservation has increased over the last two years and will continue to do so in the future. Among these are increased investment by SJWC in conservation activities starting in 2006 with its signing of the Memorandum of Understanding with the California Urban Water Conservation Council, and increased conservation efforts,

including calls for mandatory conservation, from SJWC's water wholesaler. Exhibit SJW-1, ch. 6 (Illingworth), at 1 and 4.

In fact, consumption has been below the ten-year trend in 2009 and 2010, or, alternatively stated, the data for 2009 and 2010 clearly show that the levels of conservation in 2009 and 2010 are above the long-term trend and the adjusted forecast is in line with the consumption and conservation levels achieved in 2009 and 2010. Exhibit SJW-10, ch. 4 (Illingworth), at 4. This lower level of consumption, starting in 2009, is not the result of the proposed expanded conservation program, but instead the result of conservation programs already implemented and other factors. This reduction beyond the long-term trend will be maintained through the forecast period whether or not the increased spending is authorized. Indeed, the result of any new conservation programs authorized under this rate case proceeding will only be instituted in 2013, and the effects will only begin to be felt toward the end of the rate case period. Thus, DRA's sales forecast fails to recognize the level of conservation already achieved. Exhibit SJW-10, ch. 4 (Illingworth), at 5.

Because they are more in keeping with the Commission's adopted policies and the Legislature's requirements for conservation, environmental stewardship, and with the conservation effects exhibited over recent years, the adjusted sales forecasts proposed by SJWC are more accurate and reasonable than those proposed by DRA. SJWC's sales forecasts should be adopted.

C. The Adopted Sales Estimates Should Reflect the Effects of the Commission's Response to the Parties' Recommendations Regarding Recycled Water

With the proposed continuation of SJWC's Recycled Water Program, the total estimated recycled water usage will increase from approximately 526,205 ccf in 2011 to

669,887 ccf in 2012, 942,911 ccf in 2013, 1,232,410 ccf in 2014, and 1,539,389 ccf in 2015.

Exhibit SJW-1, ch. 20 (Hoang), at 21.

In coordination with DRA's recommendations to reject any additional investment in SJWC's Recycled Water Program after 2012, DRA recommends several adjustments to water sales forecasts. These adjustments include (1) removing SJWC's reduction of 192,800 ccf in business class total sales; (2) adding back 53 business customers forecasted to convert to recycled water customers in 2013; and (3) increasing the total sales of industrial customers by 48,900 ccf to reverse estimated recycled water substitutions in 2013. Exhibit DRA-1, ch. 2 (Rauschmeier), at 4.

SJWC agrees with DRA that if the Commission adopts DRA's recommendation to eliminate the Recycled Water Program after 2012, there will be a necessary offsetting adjustment to the potable sales estimates, but disagrees with the methodology proposed by DRA. SJWC uses a simplifying assumption that there is a one-to-one offset between recycled and potable water. Under this methodology the estimated increase of recycled water sales to Business and Public Authority customers, from the 2011 recorded sales, is deducted as a one-to-one offset to the potable sales for these customers. So, in the case that DRA's recommendations related to recycled water should be accepted, and SJWC is authorized to complete the proposed 2012 projects but not the proposed 2013 or 2014 projects, the deductions from 2013 through 2015 recycled sales forecasts should be 273,020 ccf, 562,520 ccf, and 869,500 ccf, respectively. Thus, in order to make the adjustment DRA recommends (in effect to set recycled water forecasts and potable sales offsets to 2012 levels) the deductions from Business and Public Authority potable sales, above the deductions for 2012 which would be kept, would need to be removed. Specifically, SJWC's forecasted Business sales would be increased by 139,200 ccf, 372,000 ccf, and 557,700 ccf in 2013, 2014 and 2015 respectively,

and Public Authority potables sales would be increased by 133,800 ccf, 190,500 ccf, and 311,800 ccf in 2013, 2014, and 2015 respectively. Exhibit SJW-2A, ch.2, at WP 7-3B and WP 7-11B. Under this methodology, the total sales (potable plus recycled) would stay the same whether or not DRA's recommendations are accepted, but the allocation of sales between potable and non-potable would be adjusted if SJWC's recycled program recommendations are not authorized for 2013 and 2014. Exhibit SJW-10, ch. 5 (Jensen), at 8.

D. Calculation of Operating Revenues at Present Rates Should Account for the Mountain District Uplift Charge Consistently With Disposition of the Six Mutuals Settlement.

SJWC estimates operating revenues at present rates for the years 2012 through 2015 based on the estimated average number of customer and estimated total water consumption and rates effective as of January 1, 2012. Exhibit SJW-1, ch. 7 (Jensen), at 4.

DRA argues that several adjustments must be made to accurately estimate test year revenues under present rates. These adjustments are to include: (1) all Contributions in Aid of Construction; (2) revenue collected from the "uplift charge" applied under the current Schedule 1C tariff; (3) revenue collected from the upsize meter charge; and (4) increased service charge revenue collected under the Schedule 1C tariff. Exhibit DRA-1, ch. 2 (Rauschmeier), at 4.

Although not specifically stated in rebuttal testimony, SJWC agrees with DRA's arguments on items (1), (3), and (4) above and has included these adjustments in the Test Year 2013 Present Rate Revenues included in the "SJWC Current" columns provided in the joint comparison exhibits. JCE-01: Table 1 at 1, and JCE-02: Table 1 at 1. However, SJWC disagrees with DRA's assertion regarding item (2) – "uplift charge" revenue. Instead of including the forecasted income from the elevation charge as a revenue stream, the income is included as an offset to booster pump energy consumption in WP 8-4, which is then included in total energy consumption. In short, the total forecasted purchased power costs are reduced by

this Mountain District pumped power cost for both present and proposed rates. If the Commission determines that the income should be included as operating revenue, as recommended by DRA, then the expense offset included in SJWC's WP 8-4 must be removed, increasing the total Purchased Power cost. Otherwise, the income from this elevation charge will actually be double counted against SJWC's revenue requirement. Exhibit SJW-10, ch. 5 (Jensen), at 10. SJWC notes that if the Commission approves the Joint Motion of SJWC and the Six Mutuals Water Companies, and San Jose Water Company for Approval of Settlement Agreement, then the "uplift charge" will be removed from all SJWC tariffs and this issue will be moot for the purpose of determining operating revenue at proposed rates.

IV.

ISSUES RELATING TO WATER SUPPLY PORTFOLIO

SJWC's potable water supply portfolio consists of three sources – purchased water from SJWC's water wholesaler, Santa Clara Valley Water District ("SCVWD"), pumped water from the groundwater basin (which is also managed by SCVWD), and treated surface water from SJWC's Montevina and Saratoga water treatment plants ("WTPs"). Exhibit SJW-1, ch. 3 (Jensen), at 2. SJWC forecasts the purchased water amount based on the purchased water take-or-pay contract with SCVWD and the surface supply amount based on historical surface supply production adjusted to account for reduced capacity of the Montevina WTP due to water quality restrictions and during planned upgrades to the facility. The pumped groundwater is then forecasted as the marginal source of supply making up the difference between total supply necessary (*i.e.*, potable water sales plus unaccounted for water) and purchased water plus surface water. Exhibit SJW-1, ch. 7 (Jensen), at 4.

As noted above, the capacity of the Montevina WTP will be reduced while the facility is upgraded. These upgrades, and the associated temporary capacity reduction, are

detailed in the Montevina Water Treatment Facilities Plan submitted in SJWC's pending A.10-09-019. SJWC estimates that the WTP capacity will be reduced by approximately 60% from 2013 through 2015 while the upgrades are completed. This 60% reduction is accounted for in SJWC's surface supply estimate of 1,827 Kccf in Test Year 2013. Exhibit SJW-1, ch. 7 (Jensen), at 4.

DRA agrees with SJWC's purchased water forecast, and agrees that pumped water should be the marginal supply. However, DRA makes two adjustments to SJWC's surface supply forecast. These adjustments are (1) correction of a "mathematical impossibility" in recorded surface water production in 2007; and (2) assuming a 49% capacity reduction to the Montevina WTP. Exhibit DRA-1, ch. 2 (Rauschmeier), at 5.

Regarding DRA's adjustment (1), DRA assumes that the production reported in 2007 is an error, and makes an incorrect assumption relative to the water produced in that year. The fact is that SJWC did indeed produce only 1,051 million gallons ("MG") from SJWC's surface supplies on the Los Gatos Creek and Saratoga Creek systems in 2007. Montevina Water Treatment Plant also produced an *additional* 774 MG from the neighboring Lexington Reservoir, which is owned by SCVWD. The additional water produced was recorded as purchased water to accurately reflect the short-term contractual arrangement between SJWC and SCVWD during 2007. This additional water *was not produced* from SJWC's surface water sources. San Jose Water Company has no future contracts with SCVWD to purchase and produce surface water from Lexington Reservoir, and does not anticipate any production from Lexington Reservoir during 2012-2014. Accordingly, 1,051 MG in 2007 is the correct value for the total surface water production from SJWC's sources, and is appropriate to use for forecasting purposes. Exhibit SJW-10, ch. 3 (Gere), at 3-2.

Regarding DRA's adjustment (2), DRA uses an inappropriate argument for available water treatment processing capability at Montevina WTP when assuming available processing capacity will be a reduction of 49 % of normal during construction. SJWC's estimated 60 % reduction in annual production during construction at Montevina WTP is an estimate based on several conditions that will exist during construction of the plant improvements. Although the existing plant is scheduled to be in operation during much of the improvement project, the hydraulic capacity will be reduced by half as unit processes such as filters, flocculation basins and solids handling facilities are bifurcated to allow construction of new processes and equipment on the same facility foot print. Similarly, the space occupied by the off-spec water diversion basin will be repurposed during the improvement project, and will not be continuously available to plant operators when that phase of construction begins. This means that in order to assure compliance with water quality regulations, the plant operators will need to adhere to stricter procedures in operating the plant and will therefore be forced to bypass otherwise usable higher turbidity raw water that would put them at risk of violating the surface water treatment regulations. These conditions will result in further reductions in production in addition to the losses caused by the reduction in hydraulic capacity during construction. The off-spec basin currently allows operators to temporarily divert the entire plant production away from the potable system, if the plant is unable to comply with the treated water turbidity standards. Finally, short-term outages will contribute to the production losses. Some full plant outages will be required during construction, and these zero production periods will contribute to the overall reduction in water processed during the construction years. Exhibit SJW-10, ch. 3 (Gere), at 2.

It is important to recognize that the 10 MGD plant production stated in San Jose Water Company's testimony in A.10-09-019 is an instantaneous flow rate, and does not

correlate with the amount of water the plant will be able to produce during a calendar year. This flow rate corresponds to the rate necessary to ensure that SJWC is able to reliably meet peak hot weather demand periods. To be specific, this means that 10 MGD of available processing capacity is required to be available during the construction period that coincides with warm weather. Considering all of these factors, a 60 % reduction in annual production during construction at Montevina WTP is a correct and appropriate measure. Exhibit SJW-10, ch. 3 (Gere), at 3.

V.

ISSUES RELATING TO COMPANY-WIDE EXPENSES

A. Forecast Methodologies

SJWC estimates company-wide expenses for payroll and transportation separately and then allocates these company-wide expenses among various sub-accounts in Operations & Maintenance (“O&M”) and Administrative & General (“A&G”) expenses. Exhibit SJW-2A, at WP 8-12 and WP 8-21.

While DRA disagrees with the total of these expenses in most cases (as discussed in sub-sections B and C below) DRA generally agrees with the cost allocation methodologies utilized by SJWC. Additionally, DRA references errors in the work papers that are also addressed in the sub-sections below.

In general, for all non-pass-through³ expense items discussed in Section V, Section VI, and Section VII of this brief, SJWC utilized escalation factors taken from DRA’s

³ Pass-through expense items include purchased water, pump tax, and purchased power.

September 30, 2011 memoranda on escalation rates, as well as applying a customer growth factor, to arrive at estimates for 2012 through 2013. Exhibit SJW-2A, ch. 8, at WP 8-3.

DRA generally agrees with the use of escalation factors from the DRA memoranda, but recommends that the Test Year's and Escalation Year's estimates be updated with the latest escalation factors when the comparative exhibit for the final decision is prepared. DRA-1, ch. 5 (Ma), at 14. DRA generally accepts SJWC's application of customer growth factors to expense estimates for the Escalation Years, but removes all customer growth factors in 2012 and 2013 estimates, arguing that the Rate Case Plan does not specifically allow for such application of growth factors. *Id.* at 15.

Although not stated in Rebuttal, SJWC agrees that the most current escalation factors should be used at the time of the final decision in this Application. The use of, and the reasoning for the use of, customer growth factors is discussed thoroughly in D.04-06-018, the original Water Rate Case Plan decision. In that decision, the Commission determined that “[o]n balance, we find it reasonable to allow the utilities to include customer growth in the escalation methodology. A simple, five-year average percentage change in number of customers should minimize contentiousness.” The use of customer growth escalation factors acknowledges the fact that many costs increase with an increase in the number of customers. This is especially applicable when test year expenses are forecasted by escalating recorded year expenses, as is done by SJWC for most expense items. If this factor is not included, these expenses will be under-collected as the customer base grows. Exhibit SJW-10, ch. 5 (Jensen), at 11.

The Commission further acknowledges that “utility work requirements and expenses do not necessarily increase in direct and exact proportion to customer growth”, however the Commission decided that “the cost increases caused by additional customers will

almost certainly not be zero” and thus determined that customer growth escalation should be used in forecasting expenses. Finally, it should be noted that SJWC as well as other water utilities have utilized customer growth escalation factors in this Commission-approved manner in every GRC at least since D.04-06-018 was adopted without any previous protest from DRA, and this methodology has consistently been accepted by the Commission. *Id.* at 11-10.

B. SJWC’s Payroll Expense Forecast Reflects Reasonable Cost Escalation Factors and Well-Justified Additions of New Employee Positions.

SJWC witness Denia Leal estimated the Company’s total annual payroll expense for the beginning of the year 2012 based on the 355 positions existing at that date at current salary or wage rates, and then calculated employee payroll for Test Year 2013 by indexing the 2012 payroll by the union contract escalation rate of 3% for union employees and by 5% for administrative employees and officers. The 355 current positions include four positions added to support the Company’s Capital Improvement Plan. An additional 23 positions are proposed for Test Year 2013. Exhibit SJW-1, ch. 5 (Leal), at 1-8.

DRA opposed SJWC’s forecasting methodology for payroll expense on various grounds, starting from a different base, making a number of adjustments to exclude amounts from the base, and applying lower escalation rates to forecast test year expense. DRA also proposed to disallow nearly all (24 out of 27) of the additional positions recently added or proposed by the Company. The result was a test year payroll expense estimate nearly

\$2,740,000 (7.7%) lower than SJWC's estimate of \$35,300,000. Exhibit DRA-1, ch. 3 (Montero), at 1.⁴

1. SJWC properly based its forecast of payroll expense on the most current data, while DRA's exclusion of various components of payroll expense was unjustified.

As noted above, SJWC based its test year forecast of payroll expense on the most recent payroll information, as of the beginning of 2012, for the Company's current positions, escalating to Test Year 2013 payroll expense by applying the 3% union contract escalator for union employees and a 5% factor for administrative employees and officers. DRA instead based its test year estimate on recorded payroll expense for 2011, applying a number of adjustments to exclude amounts from the base and lower escalation factors. When questioned about DRA's refusal to apply 2012 wage rates, DRA witness Montero stated that 2012 is still an ongoing year, but she acknowledged having no expectation that any wages would be diminished in the remaining months of 2012. Tr. 241:24-242:7 (Montero/DRA).

To estimate payroll expense for 2012, DRA applied for all employees and officers the 2% escalation factor in the Company's union contract, even though the actual increases in compensation for administrative employees and officers were higher. For officers' compensation, DRA recognized only the recorded 2011 base salaries, removing bonuses. In calculating 2012 payroll expense, DRA also excluded all costs for temporary or part-time

⁴ Payroll expense appears as a single line item in the detailed Joint Comparison Exhibit ("JCE") under Company Wide Expenses, Exhibit JCE-2, p. 2, line 3, but also appears as "labor" or "salaries" elsewhere in the JCE. This is because, consistent with the Uniform System of Accounts, payroll expense is allocated among several sets of accounts – operating and maintenance ("O&M") expenses, administrative and general ("A&G") expense, capitalized labor, and transportation expense. *See*, Exhibit SJW-1, ch. 8 (Jensen), at 5. Transportation expense, in turn, is allocated among O&M and A&G accounts.

employees, for temporarily vacant positions, for labor related to non-tariffed products and services (“NTP&S”), and for the four positions SJWC added in 2012.⁵ DRA then escalated this 2012 estimate by the 3% union contract escalator to reach a payroll expense forecast for Test Year 2013. Exhibit DRA-1, ch. 3 (Montero), at 3-13 to 3-18.

In rebuttal testimony, SJWC challenged DRA’s various adjustments. Ms. Leal explained the bases for the annual escalation factors for each of the payroll classes. Thus, in determining increases for union employees, SJWC conducted a compensation study on wages and benefits provided by comparable utilities, which reflected that SJWC was paying union employees an average of 95.8% of what the average peer group paid. SJWC also noted that the union agreement provided for annual contract wage increases of 2%, 2%, and 3% respectively for the years 2011, 2012, and 2013, just slightly above the DRA Energy Cost of Service Branch forecast amounts of 1.6%, 1.6%, and 1.9%, respectively. SJWC conducted similar salary surveys for administrative employees and officers, which revealed that even with the increases provided in 2012, SJWC was paying administrative employees an average of 90% of comparable averages without bonus and 92% with bonus, while the corresponding figures for officers were 88% and 103%, respectively. The study showed that SJWC’s officers were paid between the 50th and 75th percentile of the peer group after a cost of living factor was applied. Exhibit SJW-10, ch. 8 (Leal), at 8-1 to 8-3.

Ms. Leal also challenged DRA’s exclusion of officers’ bonuses and “other compensation” from their recorded 2011 base salaries. She explained that bonuses are “an

⁵ DRA’s exclusion of temporary and part-time employees was based on a claim that SJWC should be able to assign “excess capacity” (employees used to justify NTP&S for the functions to which temporary and part-time employees are assigned. However, DRA did no analysis of those functions to determine whether existing capacity in the Company could have been devoted to those functions. Tr. 246:12-248:16 (Montero/DRA).

integral part of the pay for performance compensation philosophy.” Bonuses are separated from annual salary “in order to incentivize employees to perform at the highest level possible and to meet operational goals” as defined in the Company’s “Key Performance Indicators,” which directly impact SJWC’s operational efficiency and the value provided to customers. As Ms. Leal testified, without bonuses, “annual salaries would have to be increased to meet the comparability targets . . . in order to retain high performing employees.” *Id.* at 8-3.

Ms. Leal also challenged DRA’s exclusion of temporary and part-time help from payroll expense, which she noted “has always been a component of the total payroll.” Temporary labor is provided for in SJWC’s union contracts to provide relief during peak summer months and during extended absences and enables the Company to complete preventative maintenance projects during peak periods at much lower cost than that of full-time employees – in terms of both wages and benefits. *Id.* at 8-3 to 8-4. Ms. Leal denied DRA’s claim that there was no prior request or authorization for part-time and temporary labor expense. To the contrary, SJWC has historically included forecasted expense for part-time and temporary help in its GRCs and consistently has been authorized some level of recovery for such costs. The \$192,000 included in SJWC’s Test Year 2013 payroll estimate for temporary and part-time labor should be allowed. *Id.* at 8-4.⁶

⁶ Disallowing a small expense item such as this solely because it was not expressly identified and justified in the GRC application would be contrary to one of the primary objectives of the Commission’s Water Action Plan – to “streamline CPUC regulatory decision-making. *Id.* at 8-4, *citing*, CPUC 2010 Water Action Plan, October 2010, at 3.

DRA’s exclusion from its payroll forecast of labor expenses related to temporary vacancies was similarly unjustified. Temporary vacancies occur due to the bid process required by the union contract, which allows existing union employees to bid for new or vacant positions. This process allows a union employee to “try out” for an open position, but if the “try out” is unsuccessful, the employee returns to his or her prior position and the bid process may have to be repeated several times. In any event, the short-term savings associated with vacant positions are offset by the cost of new positions. SJWC includes the salaries for new positions only for a six-month period, but many, if not all, of these positions will be filled much earlier in the year, and the expense incurred in doing so will offset savings associated with vacant positions. *Id.* at 8-8.

DRA was also wrong in excluding labor expense related to NTP&S. SJWC witness Palle Jensen testified that DRA’s exclusion of \$286,000 of 2011 labor expense related to NTP&S from the base for forecasting test year payroll cost was not in compliance with the applicable Affiliate Transaction Rules (“ATRs”). Exhibit SJW-10, ch. 5 (Jensen), at 5-35. SJWC has affirmed that the NTP&S-related labor costs meet the “excess or unused capacity” qualifications of ATR X.B, and DRA has not argued to the contrary. Accordingly, as Mr. Jensen explained, the \$286,000 of NTP&S labor expense is non-incremental – that is, SJWC would incur these labor costs with or without provision of NTP&S. Having concurred that these NTP&S labor expenses are non-incremental, DRA in effect agrees that these expenses do not increase SJWC’s payroll expense beyond what is needed to provide tariffed utility service. *Id.* at 5-36 to 5-37.⁷

⁷ The ratemaking treatment of NTP&S and associated non-incremental costs is addressed further in Section XII of this brief, below.

Finally, Ms. Leal challenged DRA's derivation of a 2012 payroll estimate by escalating the entire payroll, net of adjustments, by 2%, with an added overtime allowance. She explained that the 2012 payroll estimate "should be based on the actual increases," as provided in SJWC's work papers. The actual 2012 salaries paid were based on thorough compensation studies looking comparably to salaries paid by similar water utilities competing for the same employee pool, as discussed above, and provide the soundest basis for estimating 2012 payroll expense. Likewise, SJWC's application of a 3% increase for general payroll and a 5% increase for administrative and officer payroll are well justified for projecting payroll expense in Test Year 2013. Exhibit SJW-1, ch. 8 (Leal), at 8-8 to 9.

In short, SJWC has fully justified the methodology it used to calculate payroll expense for Test Year 2013. The actual wages and salaries paid in the year 2012 provide a more up-to-date and fully reasonable base for projecting payroll expense for 2013 as contrasted to DRA's reliance on stale data and inadequate escalation factors. In particular, SJWC demonstrated why DRA's adjustments to actual payroll costs – especially the exclusion of officers' bonuses and all expense for part-time and temporary employees – are unjustified and inappropriate. SJWC's methodology for estimating test year payroll expense is reasonable and should be approved.

2. The new positions included in SJWC's payroll expense forecast are well justified.

In addition to the four new positions added as of 2012, SJWC proposes to add a further 23 new positions in Test Year 2013. Ms. Leal assumed a July 1 start date for these new employees, and so included 50% of the annual salaries for these positions in the test year payroll expense forecast. Exhibit SJW-1, ch. 5 (Leal), at 1. The 27 new and planned positions

and the associated salaries are described in detail in Ms. Leal's testimony and attachments. *Id.* at 3-8 and Atts. 2 and 3.

DRA recommends allowing only three of the 27 new positions – fewer than SJWC already has added as of 2012. Without any evaluation of the detailed justifications SJWC provided for each of the new positions, DRA simply applies SJWC's customer growth rate of 0.3% per year to SJWC's 351 employees as of 2011 to recommend adding three new positions through 2015.⁸ Exhibit DRA-1, ch. 3 (Montero), at 3-19; Tr. 237:22-238:13 (Montero/DRA). DRA justifies this approach by reference to having used a similar (but less limiting) formula in computing an employee growth factor that was included in a settlement agreement in SJWC's last GRC. *Id.* at 3-20. That, of course, is not a sound basis for decision in this case, since the referenced settlement agreement was expressly non-precedential with respect to any disputed matter of fact or law. *See*, D.09-11-032, App. B, §11.2. DRA offers no recommendation as to the particular positions in which SJWC might place the three new employees DRA would allow. Exhibit DRA-1, ch. 3, at 3-20.

In her rebuttal testimony, SJWC witness Leal also took on DRA's proposal to disallow four positions established as of 2012 and 23 new ones proposed for the test year while allowing funding for just three new positions over the four years from 2012 through 2015. Ms. Leal testified that the four positions not presently authorized were added out of great need and one of those positions, the new Electrical Engineer, has already produced significant cost savings for the Company. In fact, the person hired to fill this position brought skills that have enabled SJWC to forego hiring a contractor to implement a mandatory ARC Flash hazard

⁸ DRA's calculation is unclear, in that 0.3% of 351 equals 1.05 and applying that factor over the four years from 2012 through 2015 would suggest adding at least four new positions.

awareness and training program. While two of the four new positions had not been filed by the end of 2011, the positions have been under active recruitment and were expected to be filled by late July. Ms. Leal explained the functions each of these four positions was designed to fill, all of which are essential to the Company's Capital Improvement Program. Exhibit SJW-1, ch. 8 (Leal), at 8-4 to 8-7.

Ms. Leal rejected DRA's contention that SJWC should only be allowed a number of new employee positions commensurate with the rate of customer growth. As she testified, "customer growth rate is only one driver of the need for additional staffing." She explained that SJWC's request for 23 new positions "is primarily driven by increasing regulatory requirements in multiple areas, growing infrastructure and capital replacement needs, technological advances, the implementation of a water recycling distribution system, and a shift to higher skills and aptitudes from routine tasks." *Id.* at 8-10. Ms. Leal went on to provide a detailed summary of the anticipated impacts of operating without each of the 23 requested positions. *Id.* at 8-10 to 8-18; *see also*, Exhibit SJW-1, ch. 8 (Leal), at 4-8. SJWC respectfully urges the ALJ and the Commission to review these portions of Ms. Leal's direct and rebuttal testimony with care, because they provide a detailed justification for each of the 23 new employee positions SJWC proposes to add in Test Year 2013 – none of which DRA has even tried to rebut. Accordingly, the Commission should allow the inclusion in test year payroll expense of the four positions added in 2011 and the 23 new positions requested for 2013, for a total of 378 positions in Test Year 2013.

C. SJWC Has Fairly Estimated Test Year Transportation Expenses.

Transportation, like payroll, is a company-wide category of expense, reported under that heading in the Joint Comparison Exhibit but subject to allocation among sub-accounts for Transportation Expense under several accounts within the broad categories of O&M and A&G

expenses. See, Exhibit JCE-2, p. 2, lines 4-9. Transportation costs are assigned among those sub-accounts based on relative historical use. In determining revenue requirement in this GRC, Transportation Expenses have been examined and estimated as separate units.

1. Transportation – Labor

As indicated in DRA’s report, the difference between SJWC’s and DRA’s estimates for Transportation – Labor is due primarily to the same disputes over payroll expense estimates that are discussed in Section V.B, above. In addition, DRA corrected a \$13,000 error in a “gross-up ratio” used in SJWC’s spreadsheet formula. Exhibit DRA-1, ch. 5 (Ma), at 5-16 to 17. SJWC accepts this correction. The remaining \$32,000 of the difference between SJWC’s and DRA’s estimates (Exhibit JCE-2, p. 2, line 4) is due to their differing payroll estimates, and should be resolved consistently.

2. Transportation – Payroll Taxes

After a pair of corrections in SJWC’s update filing identified by DRA, the remaining difference between SJWC’s and DRA’s estimates for Transportation – Payroll Taxes is due to the same disputes over payroll expense estimates as are discussed in Section V.B, above. Exhibit DRA-1, ch. 5 (Ma), at 5-17. The \$25,000 difference between SJWC’s and DRA’s estimates (Exhibit JCE-2, p. 2, line 5) is due to the differences in their respective payroll estimates, and should be resolved consistently.

3. Transportation – Insurance

The \$6,000 difference between the parties’ estimates for this expense is due primarily to SJWC’s calculation based on the recorded 2011 expense escalated to the test year, while DRA averaged the expense for 2010 and 2011, escalating that figure. Exhibit DRA-1, ch. 5 (Ma), at 5-17 to 18. DRA noted the fluctuation of this expense in recent years, but

ignored the fact that the 2010 expense was an outlier, substantially lower than the four previous years, and even the 2011 expense, on which SJWC based its estimate, was lower than the those four years, when all expenses were escalated to base year 2011 dollars. Exhibit SJW-10, ch. 5 (Jensen), at 5-12.⁹ SJWC's estimate for this expense is clearly the appropriate choice.

4. Transportation – Fuel

SJWC projected purchased fuel expense of \$848,000 based on recorded 2011 expenses escalated by a 15% annual escalation factor derived from historical increases (averaging 16%) during the five-year period 2007-2011. Exhibit SJW-1, ch. 8 (Jensen), at 2-3. In response to DRA's inquiry, SJWC further explained that increased fuel usage was anticipated due to the Company "self-performing more heavy equipment work," increased staff, and new emergency generators. DRA criticizes this "general claim of need" and notes that SJWC is acquiring more fuel efficient vehicles and that disallowing new employee positions will correspondingly reduce fuel usage. Noting fluctuations in annual fuel cost from year to year, DRA develops its fuel expense estimate based on a recorded five-year average plus standard escalation, without the additional 15% factor applied by SJWC. Exhibit DRA-1, ch. 5 (Ma), at 5-18 to 19. As a result, DRA's estimate of Transportation – Fuel expense is just \$563,000 – which is 33.6% lower than SJWC's estimate. Exhibit JCE-2, p. 2, line 7.

In rebuttal testimony, SJWC witness Andrew Gere explained that in recent years the Company has increased the amount of self-performed heavy equipment and trucking work, "steadily adding heavy equipment and trucks to its fleet." Mr. Gere listed the types of heavy

⁹ The recorded years' Transportation – Insurance expense presented in Exhibit DRA-1 n. 69 are less than those shown in Exhibit SJW-10, at 5-12 because DRA's table presents the nominal dollar amounts for each year while SJWC presents escalated values representing year 2011 dollars – a more accurate basis for selecting a base for escalation to Test Year 2013.

equipment acquired along with their in-service dates, while noting that use of this equipment for maintenance and installation work has increased the amount of fuel used. Exhibit SJW-10, ch. 3 (Gere), at 3-3 to 5. Mr. Gere also explained that compliance with more stringent emissions controls applicable to SJWC's 24 diesel-powered trucks has increased fuel use and that, due to Ford's discontinuance of a fleet program for its Escape Hybrids, SJWC plans for a slight decrease in the number of hybrid vehicles in its vehicle fleet. *Id.* at 3-5 to 6.

Thus, based on recorded experience in the base period and ongoing trends due to regulatory and market factors, SJWC has well justified the 15% annual escalator included in its estimate of Transportation – Fuel expense, while DRA's criticisms have been effectively rebutted. The Commission should accept SJWC's test year estimate of \$848,000 for this expense.

5. Transportation – Depreciation

DRA confirmed that the \$1,290,000 SJWC identified as Transportation – Depreciation expense was not also included in the Depreciation expense total in Table 14-B of Exhibit SJWC-1, but proposed substantial adjustments to the Company's estimate. DRA found an error in the net salvage percentage used for this plant sub-account, stating that it should be 19.2% rather than the 0.2% used in SJWC's Depreciation Study. Exhibit DRA-1, ch. 5 (Ma), at 5-19 to 20. DRA also adjusted the Transportation – Depreciation expense estimate to reflect DRA's recommended disallowance of proposed Transportation plant (*i.e.*, vehicles) additions, and expressed concern about the Company's provision of its Depreciation Study in a format that hampered testing and evaluating the model assumptions and inputs. *Id.* at 5-20 to 21.¹⁰

¹⁰ DRA's concern about the Depreciation Study format is addressed in Section X.A, below.

SJWC adjusted its estimate to reflect DRA's correction of the net salvage rate, which reduced SJWC's test year estimate of Transportation – Depreciation to \$831,000. The remaining difference of \$130,000 is owing to the difference in test year estimates of the investment in vehicles – which is addressed in Section IX.H, below.

6. Transportation – Other

The sub-account for Transportation – Other expense includes transportation costs related to an array of miscellaneous activities including such items as travel, telephone, contracted work, tools, licenses and permits, office supplies, outside printing and design, and maintenance agreements. This same “Other” category also appears under each of the several O&M departments, but will be addressed comprehensively here.

The major difference between SJWC's and DRA's test year estimates for these expenses is that SJWC's estimates are based on recorded 2011 amounts plus escalation, while DRA states that its estimates are based on recorded five-year averages plus escalation. Exhibit DRA-1, ch. 5 (Ma), at 5-22. In addition, DRA removes the customer growth factor in the 2012 and 2013 estimates. *Id.* at 5-34.

SJWC witness Jensen confirmed in his rebuttal testimony the categories of expenses that fall into the “Other” category, and he also confirmed that the major difference between SJWC and DRA is that the Company consistently bases its test year estimates on the recorded 2011 amount while DRA mainly applies a five-year average as its base. Mr. Jensen observed, however, that DRA has been inconsistent in this regard, applying the same 2011 base as SJWC has done in estimating Other expense for the Pumping and Maintenance – Transmission and Distribution departments. Exhibit SJW-10, ch. 5 (Jensen), at 5-17. Table PJ-5 in Mr. Jensen's testimony makes clear that DRA has selectively chosen the 5-year average in each instance where the 2011 expense exceeds that average, while agreeing with SJWC's use of the 2011

expense where the average was higher. As Mr. Jensen testified, use of the last recorded year, 2011, as a base for estimating “Other” expenses for Test Year 2013 captures the rising trend for these costs while discounting the unusually high 2010 amounts. If the Commission prefers to apply the five-year average, it should do so consistently – including the Pumping – Other and Maintenance Transmission & Distribution – Other expenses. *Id.* at 5-17 to 19.

VI.

ISSUES RELATING TO OPERATIONS AND MAINTENANCE

A general description and overview of O&M expenses is provided in Exhibit SJW-1, ch.8 (Jensen), at 1-5 and Tables 8-A and 8-B. The overall difference between DRA’s and the Company’s estimates of O&M expenses for Test Year 2013 as displayed in the Joint Comparison Exhibit is approximately \$9.1 million – a 7.9% difference between SJWC’s updated estimate of \$125.0 million and DRA’s estimate of \$115.9 million. Exhibit JCE-2, p. 3, line 40.¹¹ The issues addressed under this heading concern a substantially smaller number of dollars, however, because there is no disagreement as to the \$45.1 million estimate of Purchased Water expense and the parties’ drastically different estimates of Conservation expense (\$7.6 million for SJWC but just \$78,000 for DRA) are discussed separately in Section XI, below.

A. Purchased Services

The Company estimated test year Purchased Services expense based on the five-year inflation-adjusted average of actual O&M purchased services expenses applying inflation

¹¹ These figures do not include the \$8 to \$9 million in estimated costs for Purchased Services that are listed as “Company-Wide Expenses” on Exhibit JCE-2, p. 2, lines 10-13, but are allocated to O&M accounts and so are discussed under that heading in this brief.

factors provided by Commission staff, to which were added projected expenses to conduct a system-wide ARC Flash assessment and implement Arc Flash hazard awareness training and labeling, to provide additional information technology (“IT”) education, training, and contracted work, and to satisfy increasingly stringent water quality standards. Exhibit SG-1, ch. 8 (Jensen), at 2-4; *see also*, Exhibit SG-2A (work papers), at 8-18. Similarly to “Company Wide Expenses”, Purchased Services expenses are allocated amongst various O&M Expense sub-accounts.

DRA addressed purchased O&M services (labeled as “Purchased M&S”) in Chapter 5, Section E of its report, while addressing purchased services and regulatory fees related to water quality in a separate Section F. *See*, Exhibit DRA-1, ch. 5 (Ma), at 22-30. The issues presented in these areas are discussed below. Application of a customer growth escalation factor is discussed in Section V.A, above.

1. SJWC justified incremental adjustments to baseline estimates for purchased O&M services, especially for Arc Flash assessment and IT projects.

DRA accepted SJWC’s use of the five-year escalated average to forecast baseline expenses for purchased O&M services excluding water quality, but took issue with all of the projects for which the Company made incremental adjustments to the baseline estimate. Specifically, DRA challenged the need for the additional \$240,000 per year that SJWC forecasted for the Arc Flash assessment project, asserting that a newly-hired electrical engineer can handle the project at lower cost than SJWC budgeted for an outside contractor. DRA further claimed that the additional IT-related projects could be adequately funded through “fluctuations in annual expenses” that indicate old needs going away and new needs developing. On these grounds, DRA opposed any adjustments to the baseline forecast. Exhibit DRA-1, ch. 5 (Ma), at 22-24.

As noted in SJWC's direct testimony, the Arc Flash assessment and hazard awareness programs must be implemented pursuant to OSHA requirements and include an engineering analysis of all electrical systems, a detailed hazard assessment report, labeling of all electrical cabinets, implementation of safe work procedures, and Arc Flash and Shock Hazard Electrical Safety training for all employees who work in or around any electrical systems. Exhibit SJW-1, ch. 8 (Jensen), at 2-3. In rebuttal testimony, Mr. Gere explained that failing to identify electrical hazards and appropriately train employees can result in injuries or death due to exposure to an arc flash event. Mr. Gere noted the industry standards and regulations with which SJWC must comply. Exhibit SJW-10, ch.3 (Gere), at 3-8 to 9.

Regarding DRA's claim that a newly-hired electrical engineer could be given responsibility for the Arc Flash assessment and training program, Mr. Gere noted that SJWC had notified DRA of this option as a less costly alternative to the retention of an electrical engineering consultant at an estimated cost of \$720,000 (over three years) to perform these services. *Id.* at 3-9 to 10. Unfortunately, as Mr. Gere testified, DRA recommended excluding both the consulting fees associated with SJWC's original expense estimate and the labor expense associated with performing the work in house. While not challenging the need for the Arc Flash hazard assessment and training program, DRA offered no recommendation for how to implement or fund such a program. *Id.* at 3-11.

DRA had no questions on cross-examination for either Mr. Jensen or Mr. Gere about the Arc Flash program. When asked about DRA's contradictory recommendations, DRA witness Ma could only fall back upon DRA's willingness to allow three new positions (over a four-year period), one of which SJWC *might* choose to assign to the electrical engineer who could be given responsibility for the Arc Flash program. Tr. 300:18-301:28 (Ma/DRA).

Mr. Jensen described the incremental IT programs, which DRA would disallow, as consisting of additional IT education and training, contracted work, and maintenance agreements. Exhibit SJW-1, ch. 8 (Jensen), at 3-4. Dana Drysdale, SJWC's Vice President of Information Systems, provided rebuttal testimony explaining the need for funding these IT programs. He explained that consideration of actual 2010 and 2011 expenses and committed expenses for 2012 provided a valid basis for the level of IT program funding SJWC has requested. He noted that, due to large-scale systems implementation work, SJWC's IT staff had little time for training in recent years, and so incremental expenses in this area must be anticipated. Exhibit SJW-10, ch. 2 (Drysdale), at 2-2 to 3. He broke down the recent recorded and 2012 committed costs for IT-related contracted work and explained the purposes for each of the listed projects. He further explained that recent implementation of a new customer information system and a new GIS system, both authorized in SJWC's last GRC, presented increased need for contracted services. Contrary to DRA's claim that these expenses "fluctuate significantly," Mr. Drysdale testified that "these expenses fluctuate only when new systems are installed," and the needs for these expenses "are established based on CPUC authorized projects, not changing operating need." *Id.* at 2-4 to 7. Finally, Mr. Drysdale explained the benefits provided by the Company's IT maintenance agreements and that the recent recorded and 2012 committed expenditure levels for these agreements have been "directly driven by CPUC authorized capital projects." *Id.* at 2-7 to 9.

Mr. Drysdale's testimony regarding the need to base IT-related purchased services expense on recent actual and currently committed costs supports SJWC's inclusion of incremental IT-related project costs in its Test Year 2013 estimate of Purchased Services – O&M expenses. DRA chose not to ask either Mr. Jensen or Mr. Drysdale any questions with respect to their testimony on this subject. DRA witness Ma did not challenge the need for any

of the IT-related projects SJWC proposed, but challenged only SJWC's forecasting methodology. Tr. 308:21-27 (Ma/DRA).

As noted, Mr. Drysdale fully justified basing the test year estimate of IT-related project costs on recent actual and currently committed costs. SJWC's forecast of these costs is well justified and should be approved.

2. SJWC fully justified the expenses projected to be incurred to comply with additional water quality regulatory requirements.

With respect to purchased services related to water quality and treatment activities, DRA accepted SJWC's use of the five-year escalated average to forecast baseline expenses subject to removal of the customer growth escalation factor (discussed under the heading of Forecast Methodologies in Section V.A, above) and the correction of "several errors" in SJWC's recorded data, but proposed to disallow all estimates associated with additional water quality activities. These adjustments are entirely in the area of Operations, rather than Maintenance (where there is no significant difference between the parties). Exhibit DRA-1, ch. 5 (Ma), at 5-24 to 29; see also, Exhibit JCE-2, p. 2, lines 11 and 12. The alleged corrections are to decrease the recorded amounts by \$12,000 for 2007 and \$25,000 for 2008, which has the effect of less than an \$8,000 reduction in the five-year average baseline, justifying less than a 2% reduction in SJWC's updated test year estimate of \$659,000 for this account. The bulk of the \$216,000 difference between SJWC's and DRA's estimates has to do with DRA's proposals to disallow costs for specific water quality programs proposed by SJWC. Exhibit DRA-1, ch. 5 (Ma), at 5-26 n. 87; Exhibit JCE-2, p. 2, lines 11.

Mr. Jensen listed in his direct testimony the additional water quality expenses for which allowances were included in test year revenue requirement. Three of these related to Purchased Services: ongoing monitoring costs for Synthetic Organic Contaminants of \$16,730

beginning in 2014; one time monitoring costs for Unregulated Contaminants Monitoring Rule (“UCMR”) 3 of \$100,000 in 2013, and ongoing compliance with revised NPDES permit standards of \$100,000 beginning in 2012. Exhibit SJW-1, ch. 8 (Jensen), at 4. The need for SJWC to incur each of these incremental expenses was explained by Francois Rodigari, SJWC’s Director of Water Quality and Environmental Services. Exhibit SJW-1, ch. 16 (Rodigari), ¶¶5, 15, and 19, at 2, 4-5.¹² DRA proposed to remove the \$100,000 one-time UCMR 3 monitoring costs (increased to \$113,430) from Test Year 2013 expense based on the misunderstanding that the cost would be incurred in 2012 and also would remove a \$158,400 cost incurred four years ago to comply with UCMR 2. DRA also challenges the ongoing character of the additional costs of \$100,000 and \$16,730 projected to begin in 2012 and 2014, respectively, in both cases adjusting larger amounts out of the baseline average of five recorded years’ expense. Exhibit DRA-1, ch. 5 (Ma), at 5-26 to 28.

In rebuttal testimony, Mr. Rodigari corrected the timing of the cost to comply with UCMR 3, confirming that this will be a one-time cost incurred in 2013, and requesting that the cost either be included in Test Year 2013 expense or be charged to a Water Quality Memorandum Account. Exhibit SJW-10, ch. 13 (Rodigari), at 1-2. Mr. Rodigari explained why the additional cost for complying with a revised NPDES Compliance Standard (including a new zinc permit limit) would be \$131,000, rather than either the \$100,000 originally estimated by SJWC or the \$48,846 calculated by DRA. Retaining the original \$100,000 estimate of this incremental, ongoing water quality compliance expense in the test year estimate is the least that should be allowed.

¹² A reference in Mr. Jensen’s testimony to 2012 as the time when one-time monitoring costs for UCMR Rule 3 would be incurred was mistaken, as indicated by Mr. Rodigari’s testimony. *Compare*, in Exhibit SJW-1, ch. 5, at 4, with ch.16, ¶ 15, at 4.

DRA has sought to play games with the estimation of purchased services necessary to meet ever more stringent water quality standards, reducing the proposed allowance below the escalated five-year historical average without even a suggestion that any of the historically incurred costs or the incremental future costs were or will be imprudent or unnecessary. The Commission should not condone or accept this “nickel and dime” attitude toward the utility’s essential task and duty of fully complying with present and future water quality regulations. SJWC’s proposed \$659,000 budget for this category of O&M expense in Test Year 2013 should be approved.

3. Water Quality Regulatory Fees are another source of additional costs that should be allowed.

DRA has also taken an overly restrictive approach regarding the test year estimate for Water Quality Regulatory Fees. SJWC presented a test year estimate of \$373,000, based on an escalated five-year average with additional recognition of a \$50,000 cost in each of 2012 and 2013 to obtain a new NPDES permit, an ongoing increase of \$32,000 per year in Department of Public Health (“DPH”) water system fees beginning in 2012, and a one-time 2013 cost of \$250,000 to obtain new permits and agreements from the U.S. Army Corps of Engineers, the San Francisco Regional Water Quality Control Board, and the Department of Fish & Game necessary for ongoing watershed maintenance activities, described broadly as a Watershed Maintenance Regional General Permit. Exhibit SJW-1, ch. 8 (Jensen), at 4, and ch. 16 (Rodigari), ¶¶20-22, at 5-7.

DRA proposed to exclude the \$32,000 increase in DPH fees, contending that the five-year average estimate “already reflects about \$40,750 for Water System fees. Regarding the \$50,000 allowance requested for a new NPDES permit, DRA noted that SJWC provided an updated cost sharing estimate of \$27,995, which DRA was willing to accept. DRA did not

oppose the request to recognize an additional \$250,000 expense to obtain a Watershed Maintenance Regional General Permit, but because SJWC has indicted the project will take two years to complete, DRA proposed to amortize the cost over the 2013-2015 period, including an increase of \$83,333 per year to the baseline estimates for 2012, 2013, and 2014. Exhibit DRA-1, ch. 7 (Ma), at 5-29 to 30.

In rebuttal testimony, Mr. Rodigari disagreed with DRA's claim that the past five years' average of Water System Fees paid to DPH is representative of the fees SJWC will be required to pay in the years 2012 through 2014. He noted that DPU has raised its hourly rates and expects to conduct more sanitary surveys – with corresponding increases in charges to SJWC. Recent increases in DPH billings and further increases in connection with SJWC's capital improvement program confirm the need to allow more than the historical average for this expense. Based on DRA's testimony, SJWC reviewed its estimate, developing a linear regression of the fees paid in years 2009 through 2011, which supports an estimate of DPH fees of \$69,802 for Test Year 2013, which in turn supports addition of \$19,000 rather than the previously requested \$32,000 to the escalated baseline estimate for Regulatory Fees expense. Exhibit SJW-10, ch. 13 (Rodigari), at 13-3 to 4. On cross-examination, DRA witness Ma was unwilling to accept even that incremental adjustment to the baseline estimate, doubting that a linear regression based on three data points is appropriate. Tr. 312:9-313:5 (Ma/DRA). That is a weak basis for objecting to a small allowance proposed to recognize what is clearly an increasingly costly regulatory regime.

Mr. Rodigari also opposed DRA's recommendation of amortizing the cost of obtaining a Watershed Maintenance Regional General Permit over three years. He explained that SJWC expects to expend the \$250,000 budget for this project in 2013, and there will be

further expense in 2014 as SJWC staff shepherds the necessary permits through each of the responsible agencies. Exhibit SJW-10, ch. 13 (Rodigari), at 13-4.

SJWC accepts DRA's proposal that the revised estimate of \$27,995 for NPDES permit costs be added to the baseline estimate for Test Year 2013 and proposes that an incremental cost of \$19,000 for DPH Water System Fees also be included, along with the \$250,000 test year cost of obtaining a Watershed Maintenance Regional General Permit. This would result in an allowance of \$360,000 for Water Quality Regulatory Fees in Test Year 2013, which is \$13,000 less than the amount reflected in the Joint Comparison Exhibit. *See*, Exhibit JCE-2, p. 2, line 13. That allowance has been amply justified.

B. SJWC's Estimates for the Several Elements of Operating Expenses Are Reasonable and Should Be Approved.

SJWC set forth the major classifications of operating expenses in Tables 8-A and 8-B in Exhibit SJW-1, ch. 8 (Jensen). The same classifications, with a further breakdown of Customer Accounts expenses, are set forth in Exhibit JCE-2, p. 3, lines 16 to 31. The largest category of operating expenses is Purchased Water, for which, as noted above, the parties agree on a test year estimate of \$45.1 million, as stated both in Table 8-B and in Exhibit JCE-2, p.3, line 16. The category of Customer Accounts – Conservation is addressed in Section XI, below. Differences between the parties' positions as to the remaining operating expense classifications are discussed in the following paragraphs.

SJWC notes that the unit costs for purchased water must be updated for the increase in Purchased Water unit charges implemented by SCVWD in 2012. Currently effective Purchased Water unit costs were updated from \$669 per acre-foot to \$722 per acre-foot, for which the Commission granted SJWC rate relief via an offset effective July 1, 2012 (Advice Letter 439B, effective July 1, 2012).

1. Other Source of Supply

The differences between SJWC's and DRA's methods of estimating Test Year 2013 for the "Other" categories of expenses in several different accounting classifications have been discussed comprehensively in the context of Transportation Expenses – Other in Section V.C.6, above. On the basis of that discussion, SJWC urges the Commission to adopt the Company's estimate of \$1,091,000 as a reasonable forecast of Other Source of Supply expense for Test Year 2013. *See*, Exhibit JCE-2, p. 3, line 17.

2. Purchased Power

DRA offers a slightly higher estimate of Purchased Power expense (\$5,865,000) than does the Company (\$5,754,000). *Id.*, line 18. The difference of \$111,000 is not due to a difference in methodology, but to the fact that DRA's estimates of customer sales are higher than the Company's and, consequently, so is DRA's estimated annual water supply requirement. Because energy consumption is a function of the water supply requirement, DRA's estimate of Purchased Power expense exceeds the Company's. *See*, Exhibit DRA-1, ch. 5 (Ma), at 5-34. Accordingly, the adopted water supply requirement should determine the test year estimate of Purchased Power expense.

Mr. Jensen confirmed that SJWC and DRA are in agreement as to the composite unit price charged by SJWC's power provider – PG&E – and noted that the effective energy composite rate should be reflected in the authorized revenue requirement in this proceeding. Exhibit SJW-10, ch. 5 (Jensen), at 5-14. Mr. Jensen also noted a concern about DRA deducting energy usage associated with the Mountain District booster pumps while also including the revenue from the Mountain District elevation charges in its calculation of revenue at present rates, which results in double counting SJWC's income from the elevation charge. *Id.* Because approval of the unopposed Settlement Agreement between SJWC and the Six Mutuals, will

result in elimination of the elevation charge, this point raised by Mr. Jensen should no longer be of concern if the settlement is approved by the Commission.

3. Pump Tax

The situation regarding test year estimates of Pump Tax expense is analogous to that for Purchased Power. DRA's estimate of Pump Tax expense (\$34,358,000) exceeds SJWC's (\$33,174,000) by \$1,184,000, a variance that results not from a difference in methodology but from the fact that DRA's estimates of customer sales and, consequently, annual water supply requirement, are higher than the Company's. Because Pump Tax is applied to groundwater production, DRA's estimate of Pump Tax expense exceeds the Company's. *See*, Exhibit DRA-1, ch. 5 (Ma), at 5-35; Exhibit JCE-2, p. 3, line 19. Accordingly, the adopted water supply requirement should determine the test year estimate of Pump Tax expense.

As in the case of Purchased Power, Mr. Jensen confirmed that SJWC and DRA are in agreement as to the unit price charged by the Santa Clara Valley Water District ("SCVWD") for Pump Taxes. He noted that the SCVWD recently adopted increased Pump Tax charges to take effect July 1, 2012 (increase from \$569 per acre-ft to \$662 per acre-ft), and proposed that the effective SCVWD charges should be reflected in the authorized revenue requirement when this proceeding is concluded, since the Commission already has granted offset rate relief for the expense in Advice Letter 439B, as noted above. Exhibit SJW-10, ch. 5 (Jensen), at 5-15.

4. Other Pumping

The differences between SJWC's and DRA's methods of estimating Test Year 2013 for the "Other" categories of expenses in several different accounting classifications have been discussed comprehensively in the context of Transportation Expenses – Other in Section V.C.6, above. On the basis of that discussion, SJWC urges the Commission to adopt the Company's

estimate of \$3,021,000 as a reasonable forecast of Other Pumping expense for Test Year 2013. See, Exhibit JCE-2, p. 3, line 20.

5. Chemicals

Chemicals are a substantial element of the cost of water treatment, including not just the cost of the chemicals themselves, but also fuel-intensive delivery costs for SJWC's chemical providers, compliance taxes, and mill fees that are passed on to the water utility. SJWC's chemicals cost per million gallons of groundwater production has increased every year of the past five, with an average annual increase of 19.6% and an average increase of 22.2% over the past three years. For these reasons, SJWC estimated Chemicals expense for Test Year 2013 by adding an annual 20% increment to its recorded 2011 expense. Exhibit SJW-1, ch. 8 (Jensen), at 4, and ch. 16 (Rodigari), ¶23, at 7-8.

DRA opposed this 20% annual adjustment factor, claiming that the historical percentage increases to which SJWC referred were applicable only to 61% of SJWC's Chemicals expense and that a review of sample invoices for chemical purchases from 2009 to 2011 did not confirm an increasing trend of fuel costs, taxes and mill fees. DRA also noted that an increasing unit price in dollars per million gallons may be offset by lower demand for water. DRA favored averaging the recorded total costs, applying a three-year average to capture recent production and treatment requirements. Exhibit DRA-1, ch. 5 (Ma), at 5-36 to 39.

SJWC witness Gere provided testimony rebutting DRA's position. Mr. Gere opposed DRA's 3-year average estimation method, explaining that the volume of chemicals used in a given year depends on the amount of groundwater and surface water treated. The average cost of chemical per unit of water produced and the trend in that average cost are key factors in forecasting test year Chemicals expense. This is the basis for SJWC's estimate of a 20% annual increase in chemical costs. Mr. Gere also noted that reliance on a three-year

average failed to account for the fluctuations in annual Chemicals expense that are attributable to variations in the frequency of chemicals deliveries, and he provided an alternate calculation of the percentage increase in dollars per million gallons for all SJWC's chemicals costs, which showed a 5-year average increase of 12.2% and a 3-year average increase of 16.4%. On this basis, he concluded that the unit price increase may continue to increase at a rate of 15 to 20% per year. Based on recorded 2011 expenses and a 20% escalation rate, Mr. Gere recommended a Test Year 2013 Chemicals expense of \$519,000, exceeding DRA's \$383,000 estimate by \$136,000. Exhibit SJW-10, ch. 3 (Gere), at 3-12 to 14; Exhibit JCE-2, p. 3, line 21

DRA declined to cross-examine either Mr. Jensen or Mr. Gere regarding this subject. SJWC's chemical expense estimate was well supported and should be adopted.

6. Other Water Treatment expenses

The differences between SJWC's and DRA's methods of estimating Test Year 2013 for the "Other" categories of expenses in several different accounting classifications have been discussed comprehensively in the context of Transportation Expenses – Other in Section V.C.6, above. On the basis of that discussion, SJWC urges the Commission to adopt the Company's estimate of \$3,198,000 as a reasonable forecast of Other Water Treatment expense for Test Year 2013. *See*, Exhibit JCE-2, p. 3, line 22.

7. Transmission and Distribution expense

As stated in DRA's report, Transmission and Distribution ("T&D") expense is comprised of four components: a) Labor; b) Transportation; c) Purchased Services; and d) Other. The first three components are allocated portions of the total estimates for those cost categories as discussed in Sections V.B, V.C, and VI.A.1, above, and the last component, "Other," is governed by the same analysis presented in Section V.C.6, above. *See*, Exhibit DRA-1, ch. 5 (Ma), at 5-40. Consistent with the discussion of these cost components in the

referenced prior sections of this opening brief, SJWC urges the Commission to adopt the Company's estimate of \$4,440,000 as a reasonable forecast of Operating Expense – Transmission and Distribution for Test Year 2013. *See*, Exhibit JCE-2, p. 3, line 23.

8. Customer Accounts

Similarly to T&D expense, discussed above, Customer Accounts expense is comprised of seven components, including the four components referenced with respect to T&D expense: a) Labor; b) Transportation; c) Purchased Services; and d) Other. As in the case of T&D expense, so also for Customer Accounts expense, the first three of these components are allocated portions of the total estimates for those cost categories as discussed in Sections V.B, V.C, and VI.A.1, above, and the last component, "Other," is governed by the same analysis presented in Section V.C.6, above. *See*, Exhibit DRA-1, ch. 5 (Ma), at 5-40.

As detailed in DRA's report, Customer Accounts expense also includes three additional components: a) Uncollectibles; b) Conservation; and c) Billing Postage. The differences between the parties regarding all seven components are set forth in Exhibit DRA-1, ch.5 (MA), at 5-42. DRA accepts SJWC's estimated Uncollectible Factor of 0.1843%, so the small difference in estimated Uncollectibles expense (DRA's estimate exceeds SJWC's updated estimate by \$32,000) is due to the difference in estimated total revenues. *Id.*; Exhibit JCE-2, p. 3, line 24. Differences regarding SJWC's Conservation Programs budget are discussed in Section XI, below. Therefore, the only component of Customer Accounts expense requiring detailed examination here is Billing Postage.

SJWC's updated estimate of \$485,000 for Test Year 2013 Billing Postage expense is based on recorded 2011 plus two years of customer growth. DRA developed its estimate of \$462,000 based on an analysis of the recorded number of paper bills and e-bills, their respective unit costs and expected postage cost increases, incorporating a projection that

SJWC's annual number of paper bills will continue to decline at a rate of 3.1% per year.

Exhibit DRA-1, ch. 5 (Ma), at 5-42 to 43.

Mr. Drysdale provided SJWC's rebuttal testimony on this issue. He compared the range of per-unit fees for e-billing with the postage cost and noted that SJWC was not requesting an increase in the allowance for e-billing fees, even though the percentage of e-bills is on an increasing trend. By recommending a reduction in SJWC's estimate for Billing Postage expense with no corresponding increase in e-billing expense, "DRA's analysis reduces allowed costs for combined Billing Postage and e-bill fees below current costs and projected increases." Exhibit SJW-10, ch. 2 (Drysdale), at 2-9. SJWC's updated estimate of \$485,000 for Operating Expense – Customer Accounts – Postage is well justified and should be adopted.

Consistent with the foregoing analysis of Billing Postage expense and the discussion of the other components of Customer Accounts expense in the referenced prior and subsequent sections of this opening brief, SJWC urges the Commission to adopt SJWC's current estimates set forth in Exhibit JCE-2, p. 3, lines 24-30, as reasonable forecasts of Operating Expense – Customer Accounts for Test Year 2013.

C. Differences Between the Parties' Estimates of Maintenance Expenses Are Due to Factors Previously Addressed.

There are no disputed issues specifically relating to Maintenance Expense estimates. For each of the Maintenance Expense accounts addressed below, the expense is comprised of components that have been addressed in previous sections of this brief. The test year estimate for each of these Maintenance Expense accounts should be determined based on the resolution of issues relating to those cost components previously addressed.

1. Maintenance of Source of Supply plant

As stated in DRA's report, Maintenance – Source of Supply expense is comprised of two components: a) Labor; and b) Purchased Services. These components are allocated portions of the total estimates for those cost categories as discussed in Sections V.B and VI.A.1, above. *See*, Exhibit DRA-1, ch. 5 (Ma), at 5-43. Consistent with the discussion of these cost components in the referenced prior sections of this opening brief and allocated amongst the sub-accounts below, SJWC urges the Commission to adopt the Company's updated estimate of \$131,000 as a reasonable forecast of Maintenance – Source of Supply expense for Test Year 2013. *See*, Exhibit JCE-2, p. 3, line 32.

2. Maintenance of Pumping plant

As DRA states, Maintenance – Pumping Plant expense also is comprised of two components: a) Labor; and b) Purchased Services. These components are allocated portions of the total estimates for those cost categories as discussed in Sections V.B and VI.A.1, above. *See*, Exhibit DRA-1, ch. 5 (Ma), at 5-44. Consistent with the discussion of these cost components in the referenced prior sections of this opening brief, SJWC urges the Commission to adopt the Company's updated estimate of \$1,151,000 as a reasonable forecast of Maintenance – Pumping Plant expense for Test Year 2013. *See*, Exhibit JCE-2, p. 3, line 33.

3. Maintenance of Water Treatment plant

DRA correctly describes Maintenance – Water Treatment Plant expense as comprised of the two components of Labor and Purchased Services. These components are allocated portions of the total estimates for those cost categories as discussed in Sections V.B and VI.A.1, above. *See*, Exhibit DRA-1, ch. 5 (Ma), at 5-44. Consistent with the discussion of these cost components in the referenced prior sections of this opening brief, SJWC urges the Commission to adopt the Company's updated estimate of \$176,000 as a reasonable forecast of

Maintenance – Water Treatment Plant expense for Test Year 2013. *See*, Exhibit JCE-2, p. 3, line 34.

4. Maintenance of Transmission and Distribution plant

As stated in DRA’s report, Maintenance – Transmission & Distribution Plant expense is comprised of four components: a) Labor; b) Transportation; c) Purchased Services; and d) Other. The first three components are allocated portions of the total estimates for those cost categories as discussed in Sections V.B, V.C, and VI.A.1, above, and the last component, “Other,” is governed by the same analysis presented in Section V.C.6, above. *See*, Exhibit DRA-1, ch. 5 (Ma), at 5-45 to 46. The only DRA adjustment specific to these components of Maintenance Expense was to correct an alleged error in SJWC’s work papers. *Id.* Consistent with the discussion of these cost components in the referenced prior sections of this opening brief, SJWC urges the Commission to adopt the Company’s estimates as reasonable forecasts for the four components of Maintenance – Transmission & Distribution Plant expense for Test Year 2013. *See*, Exhibit JCE-2, p. 3, lines 35-39.

VII.

ISSUES RELATING TO ADMINISTRATIVE AND GENERAL EXPENSES

SJWC presented an overview of its administrative and general (“A&G”) expenses in Chapter 9 of Exhibit SJW-1a, for both the recorded years (2006 through 2011) and forecast years (2012-2015). Exhibit SJW-1, ch. 9 (Jensen), at 1-3 and Tables 9-A and 9-B. SJWC witness Palle Jensen explained the company’s general procedures for making test year forecasts for A&G expenses, noting that SJWC typically bases its forecasts on a five-year average of recorded figures, adjusted for inflation, unless it has specific knowledge of circumstances indicating that such data will not provide the most reliable forecast of Test Year expectations,

in which case additional information will be considered. Exhibit SJW-1, ch. 9 (Jensen), at 1-2. DRA disputed certain of these adjustments, as more fully described below.

A. Estimates of Office Supplies Expenses Warrant Attention to Increasing Cost Trends Driven in Some Cases by Commission Policy Priorities.

The category of A&G Office Supplies includes a number of transportation-related expenses, the recommended disposition of which is detailed in Section V.D. of this opening brief. The remaining contested A&G Office Supplies items are relevant to the Materials and Supplies (“M&S”) category and are discussed herein. The differences in the parties’ positions are set forth at on page 4 of the Comparison Exhibit, starting at line 2, and starting on page 5-48 of the DRA Report.

1. Utility Supplier Diversity program

In its work papers, SJWC inadvertently included only the forecasted program cost *increase* over its 2011 approved budget for its Utility Supplier Diversity Program (“USDP”) of \$90,600. Exhibit SJW-2a, ch. 9 (Jensen), at WP 9-4; *but see* Exhibit SJW-1, ch. 9 (Jensen), at 3 (requesting a Test Year 2013 budget of \$139,500). DRA did not oppose the amount erroneously included in the work papers but object to the corrected request of \$136,500 for Test Year 2013 that SJWC provided in its Response to DRA Data Request PPM-13, April 3, 2012. Exhibit DRA-1, ch. 5 (Ma), at 5-49; Exhibit SJW-10, ch. 5 (Jensen), at 5-20 to 21.

In his rebuttal testimony, SJWC witness Palle Jensen gave a detailed justification for the increased USDP budget, explaining that it was necessary to help SJWC meet the Commission’s newly mandated GO 156 requirements through expanded outreach to Women, Minority and Disabled Veterans Business Enterprises (“WMDVBE”). In 2009 the California Legislature added water companies with gross annual revenues exceeding \$25,000,000 to all compliance requirements under GO 156, requiring additional investment in program expansion

for the procurement of products and services from WMDVBE. Investment in program growth will increase overall participation of WMDVBE businesses in procurement activity. The proposed USDP expense will allow SJWC to invest in program expansion to meet GO 156's compliance requirements and should be approved. Exhibit SJW-10, ch. 5 (Jensen), at 5-21 and Att. C.

2. Landscaping, Travel and Incidental; Bank Service Charges; and Other Office Supplies expenses

For expenses associated with accounts for Landscaping; Travel and Incidental; Bank Service Charges; and Other Office Supplies, SJWC based its estimates on the 2011 recorded amounts plus escalation and customer growth factors. Exhibit SJW-2A, ch. 9, at WP 4. Instead of the 2011 recorded amount, DRA recommended using a 3-year average base period (2009-2011) escalated to Test Year 2013 for an estimated total expense of \$1,082,000. Exhibit DRA-1, ch. 5 (Ma), at 5-49. DRA cited fluctuations from year to year in these four categories of expense as justification for using more than a "one-year data point." *Id.*

In his rebuttal testimony, Mr. Jensen directly contested the justification for DRA's proposal by presenting evidence illustrating that these disputed expense items have steadily increased over time. Exhibit SJW-10, ch. 5 (Jensen), at 5-19 to 5-20. All indications are that these expenses will continue to follow this trend, which makes the 2011 recorded cost the most accurate period upon which to base an escalation to the 2013 forecast. *Id.* Therefore, SJWC's recommended total 2013 forecasted expense of \$1,139,000 should be approved.

B. Brokers' Forecasts Provide the Most Reliable Basis for Estimating Test Year Property Insurance Costs.

SJWC based its \$194,000 test year forecast for Property Insurance on an estimate provided by its insurance broker. Exhibit SJW-1, ch. 9 (Jensen), at 3. DRA recommended instead that a 5-year average percentage increase of 2.0% be used to forecast estimates for the

test year, citing the fluctuation from year to year associated with this expense. Exhibit DRA-1, ch. 5 (Ma), at 5-50.

Mr. Jensen challenged DRA's proposed escalation from recorded 2011 amounts in his rebuttal testimony and in SJWC's Response to DRA Data Request PPM-06. Exhibit SJW-10, ch. 5 (Jensen), at 5-21 and Att. D; *see also* Exhibit DRA-2 (Ma), Att. G. Mr. Jensen described the projections prepared by SJWC's insurance broker forecasting rate increases of 4.3% between 2011 and 2012 and by 8.0% between 2012 and 2013. These projections reflect current market conditions should be used to calculate the year over year escalation from the 2011 recorded costs. Exhibit SJW-10, ch. 5 (Jensen), at 5-21 and Att. D. The Commission should approve the requested amount of \$194,000 for SJWC's 2013 Property Insurance expense.

C. SJWC's Estimates for the Costs of Injuries & Damages Insurance Are Soundly Based.

1. Workman's Compensation Insurance

SJWC estimated its test year and escalation years forecast for its Worker's Compensation Insurance expense by increasing its baseline estimate by an average of the percentage increases in premiums over the three-year period from 2009-2011, or 25% each year. The 2009-2011 period captures certain of the volatility in annual premium history experienced as a result of the 2004 institution, and subsequent roll-back, of cost reduction reforms, but excludes years where booked expenses were artificially low due to the application of credits from retrospective years (dating back to 2003-2006) that the Company will not receive on a going-forward basis. Exhibit SJW-1, ch. 5 (Leal), at 11.

DRA notes an incorrectly calculated WCI:Labor expense ratio and recommends a ratio of 1.44%. Further, DRA agreed that an annual adjustment to reflect increasing recorded

Workers Compensation Insurance expense was appropriate, but recommended that an annual factor of 9% be adopted. Exhibit DRA-1, ch. 5 (Ma), at 5-52.

Although not stated in Rebuttal, SJWC acknowledges the correction to the WCI: Labor expense ratio and uses the accurate ratio of 1.44% to arrive at the “SJWC Current” value provided in the Joint Comparison Exhibit. SJWC stands by the original escalation rate of 25% as submitted in its Application, supporting the adjusted estimate of \$637,000 for Test Year 2012. Exhibit JCE-2, p.4, line 45.

2. Public Liability Insurance

SJWC based its Test Year 2013 forecast of \$850,300 for Public Liability Insurance (“PLI”) on estimates provided by its insurance broker. Exhibit SJW-1, ch. 9 (Jensen), at 3. DRA recommended instead that the PLI expense be based on 2011 recorded costs plus a 2% escalation factor – citing a steady decline in recorded annual amounts for this expense since 2009. Exhibit DRA-1, ch. 5 (Ma), at 5-52 to 53.

As with its Property Insurance forecast, SJWC sought the expertise of its insurance broker to inform the development of its PLI expense forecast. In rebuttal testimony, Mr. Jensen described SJWC’s methodology for calculating the expense forecast. First, SJWC took the rate projections prepared by the company’s insurance broker and used them to calculate the year over year escalation for each of the PLI cost components (excluding brokerage fees). From there, SJWC produced a weighted average escalation factor based on the escalation factors associated with each cost component and the 2011 percentages of the total expense to generate an escalation factor of 8% in 2012 and 5.4% in 2013. Using the historical 5-year average expense and these carefully calculated escalation factors, SJWC projects a 2013 expense of \$850,300. Exhibit SJW-10, ch. 5 (Jensen), at 5-22 and Att. D. SJWC’s methodology for estimating test year PLI expense is sound and should be approved.

D. SJWC’s Estimate of Regulatory Commission Expense Properly Recognizes the Increasing Cost of Regulatory Proceedings and Should Be Approved.

SJWC estimated its Regulatory Commission expense of \$1,000,000 based on the assumption that, over a 3-year period, the Company will incur legal, consulting and other fees associated with a fully litigated GRC, one cost of capital proceeding, at least one formal application coming out of the GRC, and miscellaneous legal and consultant work not related to a formal proceeding such as an OIR. Exhibit SJW-1, ch. 9 (Jensen), at 2; Exhibit SJW-2a, WP-9-8; Exhibit SJW-10, ch. 5 (Jensen), at 5-24 to 25. SJWC also provided DRA with a breakdown of forecasted costs by category, illustrating the considerable escalation of costs incurred from the 2006-2008 period to the 2009-2011 period attributable to the increasing amount and complexity of regulatory activity. Exhibit DRA-1, ch. 5 (Ma), at 5-54.

In its Report, DRA rejected SJWC’s proposal and concluded that SJWC had not provided “adequate information to justify the reasonableness” of its estimate for Regulatory Commission expense – apparently ignoring SJWC’s presentation regarding the regulatory climate and anticipated volume of regulatory work. Exhibit DRA-1, ch. 5 (Ma), at 5-54 to 5-55. Instead, DRA recommended that the Commission adopt the amount of \$689,000 – which is the total recorded cost from the last three-year period – as SJWC’s 2012-2014 Regulatory Commission expense.¹³ Exhibit DRA-1, ch. 5 (Ma), at 5-55 to 56.

In his rebuttal testimony, Mr. Jensen detailed the significant increase in expenses tracked to the Company’s Other Regulatory Commission Expense account in recent years. In addition to the increasing *number* of active regulatory proceedings precipitated by the May 2007 changes to the Rate Case Plan (separate GRC and cost of capital proceedings) and the

¹³ DRA used the same amortization and escalation methodology as proposed by SJWC.

trend to require separate applications between proceedings (for example, to request authorization for individual projects), Mr. Jensen attributed cost escalations to the increasing *length, complexity, and contentiousness* of regulatory proceedings – all factors that compel SJWC to invest in proceeding-related services and all factors that are expected to continue or steadily rise. Exhibit SJW-10, ch. 5 (Jensen), at 5-23 to 25.

DRA did not contest the validity of these trends, but argued that the addition of one regulatory staff position in 2010 should help SJWC “reduce or at least contain” these costs. Exhibit DRA-1, ch. 5 (Ma), at 5-55. Although an essential asset to SJWC’s regulatory case load management, the addition of a single employee position does not: (1) replace the need for specialized outside legal counsel and consultants to address highly complicated issues, which accounts for the largest component of the Regulatory Commission expense category, or (2) otherwise address the cost increases that are attributable to participating in lengthier and more adversarial proceedings. Exhibit SJW-10, ch. 5 (Jensen), at 5-23 to 25. Moreover, even with the 2010 addition, SJWC’s Regulatory Affairs Department is small, particularly for such a large investor-owned utility. Exhibit SJW-10, ch. 5 (Jensen), at 5-30. SJWC maintains a staff of only three employees dedicated to ensuring compliance with CPUC regulations, timely filing regulatory filings, participating in ongoing proceedings and preparing for the GRCs and cost of capital proceedings. *Id.* Accordingly, the requested amount for SJWC’s Regulatory Commission expense is reasonable, fully justified, and should be approved.

E. SJWC’s Estimates of Outside Services Expenses Are Reasonable.

The category of A&G Outside Services includes components for “Outside Services – Legal” and “Outside Services – Other.” SJWC’s estimates for both categories are reasonable.

1. Outside Services – Legal

SJWC estimated the Outside Services – Legal expense by using the base year 2011 annualized estimate of \$700,000 and including the customer growth escalation factor and specific expenses associated with the Records and Information Management (“RIM”) project to derive a Test Year 2013 expense of \$895,000. DRA estimated Outside Services – Legal expense by escalating the recorded 2011 expense of \$450,000 and excluding all additional RIM-related project expenses and the customer growth factor discussed in Section VII.I.1 of this opening brief. Using this methodology, DRA derived a total estimate of \$467,000 for Test Year 2013.

In his rebuttal testimony, Mr. Jensen disputed the suitability of using the recorded 2011 expense as the basis for the expense calculation going forward. The annual expense for each of the four years prior to 2011 – recorded during the period 2007-2010 – exceed the 2011 expense by \$24,000, \$218,000, \$167,000 and \$224,000, respectively. In comparison to the historical trend, the 2011 expense amount is disproportionately low. Mr. Jensen explained that this was the direct result of the company having received reimbursements for approximately \$360,000 in legal fees related to a lawsuit concluded in 2011, which offset the Outside Services – Legal expense and should be accounted for as an irregular occurrence. Exhibit SJW-10, ch. 5 (Jensen), at 5-25 to 26. Even the annualized estimate of \$700,000 provided in SJWC’s Application was under-estimated. The need and justification for the Records and Information Management project is discussed in Section IX.F below. DRA does not challenge the level of RIM expenses associated with the project, thus if the Commission authorizes the capital project the associated expenses should be authorized as well. Accordingly, the Commission should reject DRA’s proposed methodology and estimate for Test Year 2013 Outside Services – Legal and approve SJWC’s forecast of \$895,000.

2. Outside Services – Other

The only difference between the parties with respect to SJWC’s Outside Services – Other expense is the issue DRA raised regarding the Company’s inclusion of a customer growth factor, as discussed in Section V.A.1 of this opening brief. Exhibit SJW-2A, ch. 9, at WP 9-8; Exhibit DRA-1, ch. 5 (Ma), at 5-56 to 58. If the Commission authorizes the inclusion of the customer growth factor as proposed by SJWC, the Company’s expense estimate of \$1,989,000 should also be approved.

F. The Costs SJWC Includes in Its Forecasts of Dues and Memberships Expenses Are Appropriate for Recovery in Rates.

SJWC based its \$472,200 estimate of Dues and Memberships expense by escalating 2011 recorded data. Exhibit SJW-1, ch. 9 (Jensen), at Table 9-B. The Dues and Memberships expense category consists of both Company Dues and Employee Dues.

1. Company Dues

While, DRA did not generally object to SJWC’s use of 2011 recorded data as the baseline, DRA recommended the Commission make various adjustments to specific company membership dues. Exhibit DRA-1, ch. 5 (Ma), at 5-58 to 61.

Specifically, DRA adjusted SJWC’s California Water Association (“CWA”) dues estimate to eliminate the use of 2011 recorded data and use a non-inflation adjusted 5-year average instead, noting only that “dues vary year to year.” Exhibit DRA-1, ch. 5 (Ma), at 5-59; *see*, Exhibit SJW-10, ch. 5 (Jensen), at 5-26 to 27. As noted in Mr. Jensen’s rebuttal testimony, with the exception of 2010, CWA dues have steadily increased over time because they are tied to recorded utility revenue. *Id.* Also, SJWC expects that fees associated with CWA participation in what the Company has experienced to be the increasingly complex and costly

regulatory environment (described in the context of Regulatory Commission expense above) will also steadily increase. *Id.*

DRA also adjusted SJWC's National Association of Water Companies ("NAWC") dues estimate by removing the escalation factor, citing "no observable, consistent increases in recorded dues." Exhibit DRA-1, ch. 5 (Ma), at 5-59. To the contrary, NAWC dues track recorded utility revenue, and will therefore increase over time as recorded revenues rise. Exhibit SJW-10, ch. 5 (Jensen), at 5-27. Therefore, the escalation should be included and SJWC's 2013 estimate of \$133,342 should be adopted.

Last within the Company Dues component, DRA recommended the Commission disallow fees for SJWC's membership in various Chambers of Commerce, reducing SJWC's Company Dues request by the sum of all such dues combined, or \$48,051. Exhibit DRA-1, ch. 5 (Ma), at 5-60. SJWC urges the Commission to consider the considerable benefits derived from participating in these local, customer-oriented organizations, including staying current on regulatory issues affecting businesses, supporting the local community, and being in direct contact with SJWC's commercial customers. Exhibit SJW-10, ch. 5 (Jensen), at 5-27. Accordingly, the requested recovery for dues associated with SJWC's Chambers of Commerce memberships should be approved.

2. Employee Dues

SJWC requested the Commission adopt an Employee Dues estimate of \$28,000. Exhibit SJW-1, ch. 9 (Jensen), at Table 9-B. DRA recommended disallowance of Employee Dues for membership in various community-based organizations, including the Quota Club, Rotary Club, San Jose Lions Club, and the San Jose Athletic Club, claiming that it is "unclear" what ratepayer benefits result from these employee memberships. Exhibit DRA-1, ch. 5 (Ma), at 5-59 to 60.

As indicated in rebuttal testimony, athletic club membership is a component of executive compensation necessary to attract high-quality management, which in turn, benefits ratepayers through better overall utility operations. Exhibit SJW-10, ch. 5 (Jensen), at 5-28. Therefore, SJWC recommends the Commission adopt the total Employees Dues estimate. *Id.*

G. SJWC's Estimate of Rents Expense Is Reasonable.

SJWC based its Rents expense of \$482,000 on an escalated five-year average. Exhibit SJW-1, ch. 9 (Jensen), at 1 and Tables 9-A and 9-B. DRA recommended the forecast be based on the 2011 recorded year, adjusted to reflect the current rent amount for the 2110 South Bascom Avenue facility, to reach an estimated \$311,000 for the Test Year 2013. Exhibit DRA-1, ch. 5 (Ma), at 5-61.

SJWC agrees that DRA's methodology would provide an accurate forecast, but disagrees with the calculation DRA performed in order to arrive at its forecasted rent expense for 2013. Exhibit SJW-10, ch. 5 (Jensen), at 5-28 to 29. Applying the appropriate weighted escalation factors for 2012 and 2013 to the 2011 recorded values for each of the components included in the Rents expense category produces a forecasted 2013 Rents expense of \$382,000, which the Commission should approve. *Id.* Upon reviewing SJWC's Rebuttal Testimony, DRA agreed that \$382,000 is an "appropriate rent expense for test year 2013." Tr. 320:2-320:5 (Ma/DRA).

H. Transferred Expenses Are Properly Estimated Based on a Five-Year Average.

SJWC estimates Administrative Transferred Expenses based on the recorded 5-year average. These expenses consist of costs related to work performed for SJWC affiliates, administrative costs related to capitalized construction projects, and some incremental costs related to provision of non-tariffed products and services. These Administrative Transferred Expenses are treated as a reduction to total operating expenses, and those are not included in

revenue requirement and are not passed along to ratepayers. SJWC's Test Year 2013 estimate for Administrative Transferred Expenses is \$6,393,000. Exhibit SJW-2A, at WP 9-9.

DRA argues that SJWC's use of a 5-year recorded average is not supported by trends observed in recorded Administrative Transferred Expenses and that recorded 2011 values, plus escalation, should be used to forecast Test Year 2013 Transferred Expenses. DRA further accuses SJWC of trying to "have it both ways" in forecasting expenses. DRA's Test Year 2013 estimate for Administrative Transferred Expenses is \$7,617,000. Exhibit DRA-1, ch. 5 (Ma), at 61.

The base period used for escalation purposes should be based on the expense category under consideration. In this case, a 5-year average forecasting methodology provides a smoothing effect to the fluctuations. SJWC has consistently chosen the base periods and escalation methodologies utilized based on the specific expense category under consideration. It should be noted that DRA has recommended using 3 or 5-year average methodology for several expense categories that exhibit increasing trends, and that SJWC recommends using the last recorded year base period. It seems clear that DRA can similarly be accused of trying to "have it both ways." Exhibit SJW-10, ch. 5 (Jensen), at 29-30.

I. SJWC's Estimates of Pensions and Benefits Costs Are Soundly Based and Should Be Approved.

1. Forecasting methodology

SJWC forecasts Pension and Benefits expenses utilizing various methodologies based on the specific expense forecasted as discussed for each sub-account below. Forecasted expenses as provided in the January 2012 filing were based on annualized 2011 estimates. Exhibit SJW-2, ch. 9, at WP 9-7.

DRA generally uses the recorded year end 2011 values in preparing forecasts. DRA's recommended forecasting methodologies vary by sub-account as discussed below. DRA argues that for 2012 and 2013 P&B forecasts, except Post-Retirement Benefits other than Pensions, SJWC applied incorrect escalation factors to arrive at forecasts. Exhibit DRA-1, ch. 4 (Montero), at 1-2.

Although not stated in Rebuttal, SJWC agrees to the inclusion of recorded year end 2011 expenses in the expense forecasting. Further, SJWC has corrected inflation factors for 2012 and 2013. Expense forecasts provided below and under the "SJW Current" column in Exhibits JCE-1 and JCE-2 include these adjustments. Exhibit JCE-2, Table 2, at 4, lines 56-66.

2. Retirement Plans

SJWC recommended the Commission adopt a Test Year 2013 Retirement Plans expense of \$9,721,820, based on the 2012 actual Retirement Plans expense of \$9,466,297 provided in SJWC's March 22, 2012 actuarial report, escalated by the weighted escalation factor and a customer growth factor.¹⁴ Exhibit SJW-10, ch. 9 (Lynch), at 9-4 to 5.

By contrast, DRA calculated SJWC's Test Year 2013 Retirement Plans expense based on the five-year average of 2008 to 2011 recorded data and actuarial estimates for 2012. Exhibit DRA-1, ch. 4 (Montero), at 4-3 to 5. DRA cited a number of reasons to justify the use of the five-year average, including an anticipated "rebound of financial markets to pre-2008 levels" and that an averaging is required to account for "variations in the past five years of recorded pension expense." Exhibit DRA-1, ch. 4 (Montero), at 4-4 to 5. Using this five-year

¹⁴ SJWC updated its original forecast, which was based on the best estimate available at the time of SJWC's January 3, 2012 application filing, to reflect the final actuarial report. See Exhibit SJW-1, ch. 9 (Jensen), at 3; see also Exhibit SJW-10, ch. 8 (Leal), at 9-2 to 3.

average, DRA estimated a Test Year 2013 Retirement Plans expense amount of \$7,384,000.

In his rebuttal testimony, James Lynch, SJWC's Chief Financial Officer, challenged DRA's proposed use of the five-year average, explaining the improbability of the circumstances required to result in an actual 2013 Retirement Plans expense of \$7,384,000 – a decrease of \$2,082,000 from the 2012 recorded cost of \$9,466,000. Exhibit SJW-10, ch. 9 (Lynch), at 9-4. First, increases in service costs – a major component of pension expense – are not a result of the 2008 financial downturn and are not temporary. Service cost increases are due in large part to changes in employee participant's salaries and are not likely to decrease on the order necessary to precipitate a reduction in the Retirement Plans expense as proposed by DRA. *Id.* Second, the most significant factor currently contributing to increases in pension expense is the amortization of unrecognized losses. SJWC's cumulative unamortized losses ballooned to \$41.7 million in 2012 as a result of high asset investment losses experienced by the company during the financial downturn. *Id.* In order for the Retirement Plans expense to drop to the DRA-recommended forecast of \$7,384,000, expected return on assets would need to exceed \$30,000,000 in 2012 to offset the existing loss balance being amortized. *Id.* Mr. Lynch indicated in his rebuttal testimony that this scenario is highly unlikely, and that the current amortization period of 12.50 years is not temporary. *Id.* Therefore, the actual 2012 Retirement Plans expense presented in SJWC's March 22, 2012 actuarial report should be basis for forecasting PBOP expense, upon which the weighted escalation factor and a customer growth factor should be applied to reach a Test Year 2013 Retirement Plans expense of \$9,721,820. Exhibit SJW-10, ch. 9 (Lynch), at 9-5.

During cross-examination, DRA witness Montero was presented with SJWC's response to a DRA data request, which explained the decline in Retirement Plans expense from 2010 to 2011 as having been due to a reduction in the Company's assumed rate of return on

retirement plan assets and in its investment portfolio asset ratio which caused a one-time increase in expense for 2010. *See*, Exhibit SJW-13 (Counsel), Response 4. When asked whether this response explained the 2010 decline in what was in general an increasing trend, Ms. Montero stated, “I’m not an actuary who can determine what this number [means]. It is really very technical for me.” Tr. 253:25-255:13 (Montero/DRA). The DRA witness simply saw variability and did not attempt to explain or understand it. In contrast, SJWC witness Lynch did explain the upward trend in the Company’s Retirement Plan expense and fully justified SJWC’s test year estimate of that expense.

3. Retirement Savings Plan

DRA argues that Retirement Savings Plan expense should be based on a percentage of payroll. Exhibit DRA-1, ch. 4 (Montero), at 5. In rebuttal, SJWC agreed to DRA’s methodology, but used SJWC’s forecasted payroll to arrive at the estimated 2013 expense. Exhibit SJW-10, ch. 9 (Lynch), at 5. The only other difference between the parties with respect to SJWC’s Retirement Savings Plan expense is the issue DRA raised regarding the Company’s inclusion of a customer growth factor, as discussed in Section V.A. of this opening brief. If the Commission authorizes inclusion of the customer growth factor as proposed by SJWC, the Company’s expense estimate (as presented in its rebuttal testimony) of \$1,118,000 should also be approved.

4. Employee Stock Purchase Plan

The only difference between the parties with respect to SJWC’s Employee Stock Purchase Plan expense is the issue DRA raised regarding the Company’s inclusion of a customer growth factor, as discussed in Section V.A. of this opening brief. Exhibit SJW-10, ch. 9 (Lynch), at 9-5; Exhibit DRA-1, ch. 4 (Montero), at 4-6. If the Commission authorizes

the inclusion of the customer growth factor as proposed by SJWC, the Company's expense estimate (as presented in its rebuttal testimony) of \$122,000 should also be approved.

5. Unfunded Pensions

The only difference between the parties with respect to SJWC's Unfunded Pensions expense is the issue DRA raised regarding the Company's inclusion of a customer growth factor, as discussed in Section V.A. of this opening brief. Exhibit SJW-10, ch. 9 (Lynch), at 9-5; Exhibit DRA-1, ch. 4 (Montero), at 4-6. If the Commission authorizes the inclusion of the customer growth factor as proposed by SJWC, the Company's expense estimate (as presented in its rebuttal testimony) of \$56,000 should also be approved.

6. Post-retirement Benefits Other than Pensions ("PBOPs")

SJWC recommended the Commission adopt a Test Year 2013 PBOP expense of \$1,060,740, based on the 2012 actual PBOP expense of \$1,032,854 provided in SJWC's March 22, 2012 actuarial report, escalated by the weighted escalation factor and a customer growth factor. Exhibit SJW-10, ch. 9 (Lynch), at 9-7.

By contrast, DRA calculated SJWC's Test Year 2013 PBOP expense based on the five-year average of 2008 to 2011 recorded data and actuarial estimates for 2012. Exhibit DRA-1, ch. 4 (Montero), at 4-7. DRA referred to reasons "similar" to those it cited in the context of its Retirement Plan expense recommendation (and described in Section VII.I.2. of this opening brief) to justify the use of the five-year average and the resulting Test Year 2013 PBOP expense amount of \$886,900. Exhibit DRA-1, ch. 4 (Montero), at 4-4 to 4-5 and 4-7.

In his rebuttal testimony, Mr. Lynch pointed out the problems with adopting DRA's proposed methodology. Exhibit SJW-10, ch. 9 (Lynch), at 9-6. Despite DRA's generalized claim that an "averaging of expense for the current GRC would be the most appropriate method

to protect both utility and ratepayers,”¹⁵ the scenarios under which the actual 2013 PBOP expense would decrease from 2012 recorded cost of \$1,032,854 to DRA’s 2013 forecast amount of \$886,900 are both highly unlikely. *Id.* Firstly, PBOP expense increases over the 2008 to 2012 period were largely attributable to the amortization of unrecognized gain/loss. High asset investment losses in 2009 and 2012 in particular resulted in large increases in cumulative asset losses, which in turn, increased the overall amount of the PBOP expense. In order for the PBOP expense to decrease dramatically enough to meet DRA’s recommended PBOP expense amount, the expected return on assets would need to exceed the current loss balance being amortized (which is \$3,900,000) by \$151,000 for 2012. *Id.* Mr. Lynch stressed the improbability of this outcome, as well as the unlikelihood of the second scenario – a reduction in service cost, the other primary component of PBOP expense. *Id.* Therefore, the 2012 PBOP expense, as presented on SJWC’s March 22, 2012 actuarial report, should be basis for forecasting PBOP expense, upon which the weighted escalation factor and a customer growth factor should be applied, to reach a Test Year 2013 PBOP expense of \$1,060,740. Exhibit SJW-10, ch. 9 (Lynch), at 9-7.

7. Life Insurance

The only difference between the parties with respect to SJWC’s Life Insurance expense is the issue DRA raised regarding the Company’s inclusion of a customer growth factor, as discussed in Section VII.I.1 of this opening brief. Exhibit SJW-10, ch. 8 (Leal), at 8-19; Exhibit DRA-1, ch. 4 (Montero), at 4-8. If the Commission authorizes the inclusion of the

¹⁵ Note that DRA did not provide clear justification for using a five-year average to calculate PBOP expense, but vaguely referred back to the reasons it used a five-year average for the Retirement Plans expense, of which this “averaging” rationale was one. Exhibit DRA-1, ch. 4 (Montero), at 4-5.

customer growth factor as proposed by SJWC, the Company's expense estimate (as presented in its rebuttal testimony) of \$179,000 should also be approved.

8. Medical Insurance

SJWC estimated its forecast for Test Year 2013 Medical Insurance expense using a 9% escalation factor. Exhibit SJW-1, ch. 9 (Jensen), at 2. DRA apparently incorrectly understood that this 9% escalation factor represented the five-year average of premium rate increases for *past* SJWC health care providers and recommended instead that the Test Year 2013 expense be derived by applying the most recent (for the period 2011/2012) percentage increase in premiums for Kaiser only, which is 4.29% to arrive at an estimate of \$4,429,900. Exhibit DRA-1, ch. 4 (Montero), at 4-8 to 4-9.

In rebuttal testimony, SJWC witness Denia Leal clarified that the 9% five-year average represented in SJWC's Application is *not* a composite of premium rate increases across past providers, but is based only on premium rate increases for the Kaiser HMO plan the company experienced over the 2007-2012 period. Exhibit SJW-10, ch. 8 (Leal), at 8-19 to 20; *see also* Exhibit SJW-1, ch. 5 (Leal), at 9-10. Therefore, it is entirely appropriate to use the 9% escalation factor – the five-year average of increases for the Kaiser HMO plan – to forecast SJWC's Medical Insurance expense of \$4,981,900 for Test Year 2013.

9. Dental Insurance

SJWC's used a 4% escalation factor to calculate its estimated Test Year 2013 Dental Insurance expense of \$602,100. Exhibit SJW-1, ch. 5 (Leal), at 10; *see also* Exhibit SJW-1, ch. 9 (Jensen), at 2. DRA objected to use of the 4% escalation factor and instead applied a five-year average factor of 2.71% to the recorded 2012 Dental Insurance expense level to derive a Test Year 2013 expense of \$593,400. Exhibit DRA-1, ch. 4 (Montero), at 4-10 to 11.

SJWC witness Denia Leal challenged DRA's use of a five-year average to calculate the estimate of expense in the test and escalation years, explaining that the five-year average factor was based on contracts that each provided a two-year rate guarantee. Exhibit SJW-1, ch. 5 (Leal), at 10; Exhibit SJW-10, ch. 8 (Leal), at 8-20 to 21. Because the 2012 option to renew with a two year rate guarantee was at a level 7.3% higher than the 2011 rate, SJWC prudently opted instead to contract a single year rate at 3.3% over 2011. *Id.* Taking an average of the two single-year contracts for 2011 (4.8%) and 2012 (3.3%) yields a 4% escalation increase, which more accurately reflects the Company's claim experience trend and should be used as the basis for calculating each of the 2013-2015 forecasts. *Id.*

10. Long-term Disability Insurance

The only difference between the parties with respect to SJWC's Long-Term Disability Insurance expense is the issue DRA raised regarding the Company's inclusion of a customer growth factor, as discussed in Section VII.I.1 of this opening brief. Exhibit SJW-10, ch. 8 (Leal), at 8-21 to 8-22; Exhibit DRA-1, ch. 4 (Montero), at 4-12. If the Commission authorizes the inclusion of the customer growth factor as proposed by SJWC, the Company's expense estimate (as presented in its rebuttal testimony) of \$168,100 should also be approved.

11. Other Employee Benefits

SJWC estimates a Test Year 2013 forecast amount of \$275,500 for Other Employee Benefits expense. Exhibit SJW-10, ch. 8 (Leal), at 8-21. DRA derived its estimate of Other Employee Benefits expense as a percentage of payroll expense, reasoning that the two are proportional. Exhibit DRA-1, ch. 4 (Montero), at 4-11 to 4-12. Thus, DRA calculated the five-year average of the ratio of recorded Other Employee Benefits to recorded Total Payroll expense (0.7199%) and applied it over the 2013-2015 period. Exhibit DRA-1, ch. 4 (Montero),

at 4-12. Using this methodology, DRA recommends a Test Year 2013 forecast of \$234,500 for Other Employee Benefits expense. Exhibit DRA-1, ch. 4 (Montero), at 4-11.

SJWC witness Leal argues that using a ratio of Other Employee Benefits to Total Payroll is not accurate as the expense contains many items that fluctuate irrespective of the Total Payroll. Such expenses include the cost of mandated training and licensing for distribution and treatment licenses as well as the annual certified educational units (“CEU”s) required to maintain such licensing. Given the increase in regulatory requirements to attain and maintain higher grades of certifications in this area, the expense for these licenses continue to rise at a rate that outpaces increasing payroll. Other Employee Benefits also includes the cost of retiree functions. In years where there are more retirements than the norm, the expenses are higher. This particular expense was highlighted in 2010 and will continue to escalate as we will see a steady increase of retirements well into the next 10 years due to our aging workforce. Exhibit SJW-10, ch. 8 (Leal), at 21.

12. Health Savings Account expense

The only difference between the parties with respect to SJWC’s Health Savings Account expense is the issue DRA raised regarding the Company’s inclusion of a customer growth factor, as discussed in Section VII.I.1 of this opening brief. Exhibit SJW-10, ch. 8 (Leal), at 8-20. If the Commission authorizes the inclusion of the customer growth factor as proposed by SJWC, the Company’s expense estimate (as presented in its rebuttal testimony) of \$65,100 should also be approved. *Id.*

VIII.

ISSUES RELATING TO TAX EXPENSES

A. Ad Valorem Taxes Are a Function of Utility Plant Investment.

The difference between SJWC and DRA in their current test year estimates of Ad Valorem Tax expense amounts to just \$37,000. Exhibit JPE-2, p. 5, line 69. This difference is entirely attributable to differences between the parties' estimates of Utility Plant in Service. Exhibit DRA-1, ch. 6 (Rauschmeier), at 6-1. Accordingly, the calculation of test year Ad Valorem Tax expense depends on the adopted value for Utility Plant in Service.

B. Payroll Taxes Vary With Estimates of Payroll Expense.

Payroll taxes result from the Federal Insurance Contributions Act ("FICA"), the Federal Unemployment Tax Act ("FUTA"), and the California State Unemployment Insurance Program ("SUI"). SJWC estimates payroll taxes based on the historical ratio of payroll taxes to total expensed direct payroll. Exhibit SJW-10, ch. 5 (Jensen), at 31-32. Although DRA states that both SJWC and DRA estimate payroll taxes based on the same methodology, DRA's forecast is actually based on the ratio of historical payroll taxes to *total* payroll and then applied to total *expensed* payroll. DRA-1, ch. 6 (Rauschmeier), at 1.

SJWC witness Jensen explained that due to possible fluctuations in future rates and payroll caps, SJWC forecasts FICA taxes based on the recorded ratio of these taxes to expensed payroll. SJWC's application included an incorrect ratio of 0.0779, which was based on incomplete information. During the discovery process, SJWC informed DRA that the historic ratio of payroll taxes to expensed payroll is actually 0.0926. This ratio of .0926 applied to the total expensed direct payroll provides a Payroll Tax forecast of \$2,520,000, which should be adopted by the Commission. Exhibit SJW-10, ch. 5 (Jensen), at 31-32. Payroll tax expense is a

function of payroll expense and the final authorized payroll tax will be dependent on the authorized payroll expense.

C. Local Franchise Fees Are a Function of Adopted Revenues.

SJWC pays a percentage of its gross revenues as local franchise fees to the County of Santa Clara and to some of the cities within which it serves. DRA accepts SJWC's method for calculating Franchise Fees expense and uses the same local franchise tax rate provided in SJWC's updated work papers.

The difference between SJWC and DRA in their current test year estimates of Franchise Fees expense is \$59,000. Exhibit JPE-2, p. 5, line 72. This difference is entirely attributable to differences between the parties' estimates of Total Revenues excluding deferred revenues. Exhibit DRA-1, ch. 6 (Rauschmeier), at 6-1. Accordingly, the calculation of test year Franchise Fees expense depends on the adopted values for Total Revenues and deferred revenues.

D. SJWC Has Justified Its Treatment of Net Operating Losses and Related Deductions in Calculating Income Tax Expense for Regulatory Purposes

SJWC's and DRA's estimates relevant to test year Income Tax expense, including Federal Income Tax ("FIT") and California Corporate Franchise Tax ("CCFT"), are set forth in the Joint Comparison Exhibit, Exhibit JCE-2, at page 5, lines 78-88. The differences between SJWC's and DRA's estimates total \$3,469,000. *Id.*, line 88. The differences are due in part to differences in treating or calculating the calculation of the Domestic Production Activities Deduction and the net operating loss carry-forward resulting from the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 ("Tax Relief Act"), and also reflect a difference in calculating depreciation for CCFT purposes as well as the interest expense deduction. Remaining differences are due to differences in revenues,

expenses, and rate base estimates between SJWC and DRA. *See*, Exhibit DRA-1, ch, 7 (Rauschmeier), at 7-1 to 3.

1. Ratemaking interest deduction

SJWC calculated the ratemaking interest deduction using its Weighted Average Rate Base multiplied by the authorized Weighted Cost of Debt. DRA employed the same formula, except that it applied the Weighted Cost of Debt from the pending settlement in SJWC's cost of capital proceeding, A.11-05-001, *et al. Id.* at 7-2 to 3. The \$836,000 difference between the parties for this line item reflects the different Weighted Cost of Debt factors as well as differences in the parties' estimates of Weighted Average Rate Base. *See*, Exhibit JCE-2, p. 5, line 79.

2. California Corporate Franchise Tax (depreciation)

The \$1,226,000 difference between the parties with respect to CCFT depreciation for tax purposes results from differences between SJWC's and DRA's recommended plant additions. *Id.*, line 78; Exhibit DRA-1, ch. 7 (Rauschmeier), at 3.

3. Application of Net Operating Losses and the Domestic Production Activities Deduction

Federal legislation enacted in 2004 and 2005 adopted and then modified Section 199 of the Internal Revenue Code ("IR Code"), providing for a Domestic Production Activities Deduction ("DPAD"). Internal Revenue Service ("IRS") regulations adopted in 2006 specified detail for applying the DPAD. Beginning with the 2010 tax year, Section 199 allows a deduction equal to 9% of the lesser of a) the Qualified Production Activities Income of the taxpayer for the tax year, or b) taxable income (determined without regard to Section 199) for the tax year. In addition, the Tax Relief Act of 2010 provides for 100% bonus depreciation on certain business property put into service before January 1, 2012 and 50% bonus depreciation

for certain property placed into service in 2012 or 2013. Exhibit DRA-1, ch. 7 (Rauschmeier), at 7-3 to 4.

The Commission's Resolution L-411A, effective April 14, 2011,¹⁶ ordered certain utilities, including SJWC, to establish a one-way balancing memorandum account to track any additional earnings due to the increase in deferred taxes resulting from the bonus depreciation provisions of the Tax Relief Act and to refund such extra earnings in its next GRC. SJWC established such an account, and addresses its disposition in Section XV.D of this brief. The impact on test year Income Tax expense is addressed here.

As a result of the bonus depreciation provisions, SJWC expects to report a Net Operating Loss ("NOL") for tax purposes in 2011 and 2012, and understands that an NOL reported for tax purposes can be carried forward to reduce deferred taxes (and therefore increase rate base) for ratemaking purposes. Anticipating that it will not report any taxable income after applying the NOL in years 2013 and 2014, SJWC will not be able to utilize the DPAD in those years, and so includes zero DPAD in calculating test year FIT for ratemaking purposes. DRA, however, asserts that applying prior years' NOL to test year tax calculations and deferred taxes is not appropriate because "it would be retroactive ratemaking that is contrary to the long standing Commission ratemaking practice." DRA calculated the DPAD as a deduction in test year tax calculations equal to 9% of SJWC's Qualified Domestic Production Activities Income and removed the 2011 NOL carried forward into the test year for calculating accumulated deferred taxes for ratemaking purposes. Exhibit CRA-1, ch. 7 (Rauschmeier), at 7-4 to 5.

¹⁶ Resolution L-411A, adopted June 23, 2011, revised and replaced the previously adopted Resolution L-411, retaining the April 14, 2011 effective date of the prior Resolution.

SJWC witness Kayalvizhy Rajalingam provided testimony in response to DRA's analysis of the NOL issue and DRA's calculation of the DPAD. Ms. Rajalingam took issue with DRA's claim that applying a prior year's NOL to test year tax calculations and deferred taxes is "retroactive ratemaking." She explained that the bonus depreciation provisions of the Tax Relief Act create a timing difference that results in the reporting of tax losses in years when financial reports show net income. The timing difference is recorded as a deferred tax liability, while a deferred tax *asset* is generated related to a tax NOL caused by bonus depreciation. The tax loss will be used in future years to reduce income for federal tax purposes. The deferred tax liability, net of the deferred tax asset, is an offset to rate base, which is captured in the memorandum account established pursuant to Commission Resolution L-411A. Exhibit SJW-10, ch. 12 (Rajalingam), at 12-1 to 2.

Ms. Rajalingam further explained that for financial reporting purposes, the deferred tax liability and deferred tax asset created by bonus depreciation are treated no differently than similar differences between tax and financial reporting – they are recorded as deferred taxes in the year they originate and are recognized as adjustments to taxable income in future years when they reverse or are applied. This treatment follows basic "normalization" concepts accepted and employed in accounting for income taxes by utilities. As Ms. Rajalingam testified, "[t]ax normalization does not create retroactive rate making." *Id.* at 12-2; *see also, id.* at 12-3.

Ms. Rajalingam disagreed with DRA's claim to have calculated tax deductions and credits in accordance with currently effective tax regulations. She explained that DRA would include only the effect of the excess depreciation deduction in calculating future taxable income, while excluding the net operating loss. However, she pointed out, the excess depreciation deduction creates the NOL. DRA has failed to take into account the NOL, which

tax law provides may be used either to recover previous income taxes paid or to settle future taxes due. Unlike DRA, SJWC has calculated the bonus depreciation deduction and the resulting NOL in accordance with the provisions of the Tax Relief Act and current tax law. Exhibit SJW-10, ch. 12 (Rajalingam), at 12-2 to 3.

Ms. Rajalingam also refuted DRA's claim that there should be a DPAD for each of the years 2013 and 2014. She noted that SJWC will not be eligible for the DPAD due to the taxable income limitation described in IR Code Section 199(a)(1), which allows a DPAD equal to a specified percentage of the lesser of 1) qualifying production activiiteies income; or 2) taxable income. A corporate taxpayer that reduces its taxable income by an NOL carryover also reduces the DPAD available in that year. Since the NOLs will eliminate taxable income for SJWC in 2013 and 2014, the Company is not eligible for the DPAD for either tax or financial reporting purposes. Accordingly, DRA's DPAD calculation is flawed. It is not based on the "taxable income limitation" prescribed by IR Code Section 199(a)(1), but rather is calculated based on book amounts. This is not consistent with the Tax Code. Exhibit SJW-10, ch. 12 (Rajalingam), at 12-3 to 4.

Even if SJWC were eligible to take advantage of the DPAD, DRA's calculation of a \$3.2 million deduction would not be correct. Following the guidance provided by Section 199, SJWC has calculated DPAD deductions on its Federal tax returns for years 2005 through 2010 ranging from zero to \$585,523. Ms. Rajalingam would anticipate a similar level of dedcuton, were it not for the forecasted NOL, which, as explained, reduces the deduction to zero. Exhibit SJW-10, ch. 12 (Rajalingam), at 12-5.

Finally SJWC's witness refuted DRA's claim that "SJWC is not advocating that the NOL be used to reduce its income taxes in the Test Years 2013 and 2014. The Company has stated that there will not be any taxable income after applying the NOL in those years. As

such, the DPAD will be lost for years 2011 and 2012, when the deferred tax asset originates, and for 2013 and 2014, when the deferred tax asset is applied. However, SJWC will record book federal tax expense for these years. The tax expense for book purposes (on the income statement) does not align with the tax expense actually payable for tax purposes due to the recognition of deductions and income in different periods for book and tax purposes in accordance with financial accounting and tax accounting rules. As the witness stated, this gives rise to the deferred taxes, consistent with SJWC's practice of computing income taxes on a normalized basis. *Id.* at 12-6.

For ratemaking purposes and financial reporting purposes, the deferred tax liability and the deferred tax asset arising from the bonus depreciation are calculated in accordance with the concept of basic "Normalization" that is employed in accounting for income taxes by utilities and is deducted from rate base. Therefore, SJWC's income tax calculations for all purposes – book, tax, and ratemaking – are correct.

IX.

ISSUES RELATING TO UTILITY PLANT IN SERVICE

A description of SJWC's accounting for utility plant investments is presented in Exhibit SJWC-1, ch. 11 (Jensen). Chapter 11 also presents information regarding the growth in utility plant in service for years 2006 through 2011 along with the Company's construction budgets for years 2012 through 2014. *Id.* at 2-3 and Tables 11-A through 11-D, updated at Exhibit SJWC-1A, Tables 11-A through 11-D. As indicated in Table 11-B, the most substantial planned investments are in the areas of Source of Supply, Reservoirs and Tanks, Pump Stations and Equipment, Recycled Water Pipeline Extensions, New and Replacement Mains, Services, Meters, and Green/Alternative Energy. Specific projects in each of the three

planning years are described in SJWC's "Construction Budget Detail" work papers. *See*, Exhibit SJW-2A, WP 11-8 through 11-10.

SJWC's construction budgets for years 2012 through 2014 are supported and justified in Exhibit SJW-3 (Lambing). The Company's Capital Improvement Program ("CIP") and construction budgets are generally described and explained at pages 9 to 12 of that exhibit, with the remainder of the document providing descriptions and justifications for each project with a budgeted cost exceeding \$500,000. *Id.* at 13 to 203. More detailed infrastructure planning studies of obsolete meter replacement, piping infrastructure, wells, emergency power, and replacement of the Vickery Reservoir are provided in Exhibits SJW-4 through SJW-8 and are addressed in the relevant sections below.

A. The Modest Budget SJWC Proposes for Investments in Land for Easements Should Be Approved.

SJWC proposes very minor investments in land of just \$10,000 or \$11,000 per year, while DRA would disallow any investments in land for easements over the entire period. Exhibit JCE-2, p. 6, line 95, p. 7, line 111, p. 8, line 128; Exhibit DRA-1, Table 8-B (Rasmussen), at 8-3. This budget item is intended to cover miscellaneous rights-of-way, as needed, for which past allowances have been insufficient. DRA observes that recorded spending for this purpose is "very sporadic, ranging between \$0 and \$2 million per year during the past five years. While recommending that "requests for this category be made in line with the way spending occurs," DRA proposes to cut the allowance to zero. *Id.* at 8-5 to 8-6.

DRA's position on this issue is inconsistent and unreasonable. As SJWC witness Lambing testified, SJWC's distribution system runs through non-public areas based on century old easement agreements. Ownership changes over the years and limited space within existing easements to install replacements for failing mains make it necessary to acquire alternative

rights-of-way. Such needs often do not surface until the detailed design phase for a pipe replacement project, making it impossible to specifically identify such issues and costs at the time of GRC budget development. Exhibit SJW-10 , ch. 7 (Lambing), at 7-3. DRA’s recommendation to make budget requests for this category “in line with the way spending occurs” is impractical. The modest budget SJWC requests should be granted in order to fund these needs. *Id.*

B. There Are No Issues Regarding Source of Supply Plant.

SJWC proposes to maintain its existing well replacement program, approved in the last two rate cases, which provides for replacement of two wells per year at existing well sites. *See*, Exhibit SJW-3 (Lambing), at 10, ¶2; *see also*, 2011 Wells Study, Exhibit SJW-6 (Tuttle), at 3. DRA finds the proposed costs, totaling \$15,351,100 over three years, to be reasonable and includes the full amount for Source of Supply in its recommended construction budget. Exhibit DRA-1, ch. 8 (Rasmussen), at 8-3 and 6.

C. The Replacement and Repair of Reservoirs and Tanks That Are at Issue Are Necessary and Justified.

SJWC’s construction budget for repairs, replacements, and improvements to reservoirs and tanks includes approximately \$13.3 million for 2012, \$14.3 million for 2013, and \$19.2 million for 2014, for a three-year total of just over \$46.8 million. Exhibit SJW-1A, Table 11-B. A major element of these budget amounts is \$17.7 million of a total cost of \$22.6 million for a 4-year project to replace the 7.7 million gallon reservoir at Vickery Ave Station. DRA does not object to any of the investments proposed for 2012 or 2013, but takes issues with two projects proposed for 2014 – a redwood tank replacement at Koch Lane Station budgeted for \$825,000 and a reservoir roof structure replacement and installation at Almaden Valley

Station with a \$2,467,000 budget. Exhibit DRA-1, ch. 8 (Rasmussen), at 8-3 and 8-7 to 9; Exhibit JCE-2, p. 8, lines 129-30.

1. SJWC has justified replacing the tank at Koch Lane Station.

SJWC described the facilities at Koch Lane Station and the services they provide, noting that the 100,000 gallon redwood tank is proposed for replacement due to its age and condition. The useful life of such equipment is considered to be 35 to 50 years and this tank, constructed in 1962, the tank is now 50 years old. In fact, the latest inspection report shows that the tank has failed – it has experienced severe leaking problems and repeated repair attempts have not alleviated the problems. An interior liner, installed in 1995 to relieve leakage, is itself leaking, and the tank shell and roof have rotted and failed. Exhibit SJW-3 (Lambing), at 165; *see also*, Exhibit SJW-10 (Lambing), at 7-7 to 8. The alternatives considered were to do nothing, to conduct interim repairs, or to replace the old, worn-out tank. The do-nothing alternative was rejected since it would not allow SJWC to make use of the station to provide high-quality, reliable service to the 42,000 services and 96,000 people in the Dow Zone, which is designed to be served by the facilities at Koch Lane Station. The repair alternative was rejected because the tank has reached the end of its useful life and does not meet current seismic standards. SJWC chose the “new tank” alternative because it will allow SJWC to provide high quality, reliable service for many decades to come. Exhibit SJW-3 (Lambing), at 165-67.

DRA’s only justification for not replacing the Koch Station tank in 2014, as proposed, is that “it is not required to meet current production amounts.” Exhibit DRA-1, ch. 8 (Rasmussen), at 8-9. According to DRA, Koch Lane Station has not operated since 2007, the primary source of water supply to the Dow Zone being the Santa Teresa Treatment Plant, operated by Santa Clara Valley Water District (“SCVWD”). While SJWC decided to restore

Koch Lane Station to service due to frequent maintenance outages at the treatment plant, DRA considers that SJWC can meet demand during these outages using its interzone booster pumps. *Id.* at 8-8 to 8-9.

SJWC witness Lambing contradicted several aspects of DRA's analysis. He testified that the Koch Lane groundwater production facility has in fact operated routinely to run two wells and collect water quality samples as required by DPH. He explained that Koch Lane Station is needed to supply the Dow Zone when imported water supplied through SCVWD's treatment plant is limited or unavailable. Mr. Lambing noted that frequent treatment plant outages over the past three years have been due to various causes, including limited availability of imported water from the State Water Project and other sources. He explained the serious threats to imported water supplies from the Sacramento-San Joaquin Delta, which is the source for about half of SJWC's water supply, and the need for SJWC to increase its ability to call upon its groundwater pumping facilities to meet demand in times of drought. Running inter-zone booster pumps to replace service from SCVWD's treatment plant is not an adequate substitute. Exhibit SJW-10, ch. 7 (Lambing), at 7-5 to 7.

In response to cross-examination, Mr. Lambing confirmed that the wells at Koch Lane Station are routinely operated for purposes of water quality sampling, but the station has not produced water for delivery into the distribution system since 2007. Tr. 185:19-187:8 (Lambing/SJWC). This does not, however, in any way contradict the continuing value of Koch Lane Station as a source of supply for groundwater production in the event that imported water supplies become unavailable at some future point in time. For Koch Lane Station to retain that value, replacement of the failed storage tank is required.

2. Reconstruction of the reservoir roof structure at Almaden Valley Station is required.

SJWC explained that Almaden Valley Station is an earthen reservoir storage and distribution facility, with 8.9 million gallons of storage capacity, serving the Belagatos Zone which contains 32,000 services and serves over 144,000 people. The reservoir is over 46 years old and is approaching a point when major improvements are necessary to keep it functioning properly. The original timber roof columns and support structure are rotting and in need of replacement, and the roof has inadequate pitch to shed rain water, resulting in “ponding” on the roof surface, while the aging roof may also allow rain water and other sanitary hazards to enter the tank, an obvious water quality hazard. Exhibit SJW-3 (Lambing), at 140-41; *see also*, Exhibit SJW-10 (Lambing), at 7-10 to 11. SJWC considered the alternatives of doing nothing, replacing the storage capacity, or constructing improvements. The do-nothing alternative was eliminated from consideration because it would not allow SJWC to continue to provide a high quality, safe, and reliable water supply to the many customers depending on this facility. The replacement alternative was rejected because it would have required costly location, drilling, and operation of three to four new wells to replace the volume of storage at Almaden Valley Station. SJWC chose the alternative of improving the existing reservoir because the improvements can be done in one concerted effort, rather than piecemeal in response to a series of plant failures, and will increase the facility’s structural integrity while minimizing water quality risk. Exhibit SJW-3 (Lambing), at 141-42.

Because SJWC anticipates that the reservoir at Almaden Valley Station will be included in a consultant’s structural study of several reservoirs planned for 2013, DRA argues for postponing this project until the future recommendations of the consultant’s study are incorporated. Exhibit DRA-1, ch. 8 (Rasmussen), at 8-9.

In his rebuttal testimony, SJWC witness Lambing questioned why DRA opposes the planned improvements at Almaden Valley Station while supporting very similar improvements, proposed to be undertaken earlier at More Avenue Station. Exhibit SJW-10, ch. 7 (Lambing), at 7-9 to 10. DRA's witness recognized that there has been leakage through the earthen embankment at Almaden Valley Station. Tr. 260:11-14 (Rasmussen/DRA). Since the improvements at Almaden Valley Station are not scheduled to be made until 2014, there is no good cause for delaying the needed work until even later as a result of a consultant's study.

D. SJWC Has Demonstrated Its Need for the Investments in Pump Stations and Equipment That Are Contested By DRA.

SJWC's construction budgets for 2012, 2013 and 2014 include a substantial number of projects to replace or install new pumping equipment and parts, including several Motor Control Center ("MCC") replacement projects and new standby power generators, mostly scheduled for 2014. The annual budgets are approximately \$7.5 million for 2012, \$8.0 million for 2013, and \$15.5 million for 2014. Exhibit SJW-1A, Table 11-B; Exhibit DRA-1, ch. 8 (Rasmussen)), at 8-9 to 10; *see also*, project descriptions in SJWC's work papers, Exhibit SJW-2A, WP 11-8, at 4-6, WP 11-9, at 3-4, WP 11-10, at 2-5.

DRA opposes six projects it sees as intended to increase booster pump or storage capacity at SJWC's pump stations. Exhibit DRA-1, ch. 8 (Rasmussen), at 8-10. DRA also opposes all or part of SJWC's planned investments in six out of the 14 standby generator installations SJWC has proposed. *Id.* at 8-14. As a result of these adjustments, DRA's proposed budgets for Pump Stations & Equipment are approximately \$7.1 million for 2012, \$6.0 million for 2013, and \$8.1 million for 2014. *Id.* at 8-18. DRA's proposed disallowances total more than \$9.8 million. As will be demonstrated below, each of the proposed projects meets specific, well-defined needs and DRA's broad disallowances are not justified.

1. SJWC has fully justified the MCC replacements and pump relocations and additions proposed for several pumping stations.

DRA opposes six construction projects that it sees as intended to increase booster pump or storage capacity at SJWC's pump stations. These will be addressed in turn. As will be made clear, the key driver for five of the six projects DRA opposes (all except the Buena Vista Station project) is the need to replace an ancient MCC that presents serious safety and reliability concerns – concerns that DRA consistently and inexplicably ignores.

- a. MCC replacement and pump relocation at Overlook Road Station.

Overlook Road Station has been in service since about 1918 and consists of two tanks, two booster pumps, and an MCC, and provides the only source of water for an adjacent higher pressure zone. SJWC explained that the existing 49-year-old MCC presents safety hazards for SJWC operators and electrical staff, does not provide the necessary reliability to meet operational needs, presents maintenance issues due to the difficulty of finding compatible replacement parts, and lacks efficient features of state-of-the-art MCCs. In the context of replacing the MCC, it would also be cost-effective to relocate the related pumping equipment so that the suction inlet for the booster pumps will be at the base of Tank #2, the lower tank, in which 15 feet of storage is presently unusable. Since most of the piping that would be replaced is 50 to 85 years old, it is due for replacement in any event. Exhibit SJW-3 (Lambing), at 118-19. Considering the alternatives of doing nothing or making interim repairs, SJWC concluded that replacement of the MCC and relocation of the booster pumps was justified on grounds of operational efficiency, reliability, and safety, minimal disruption of water service, and extended equipment asset life. *Id.* at 120-21.

DRA agrees with SJWC's desire to have full utilization of Tank #2, but notes that the booster pumps at Overlook Station have been in the same location for decades and argues

that “it does not appear to be urgently necessary to increase storage capacity.” Exhibit DRA-1, ch. 8 (Rasmussen), at 8-10 to 11. DRA does not offer a word of criticism about SJWC’s showing of need to replace the MCC at Overlook Station, but nonetheless would disallow the entire \$1,080,000 proposed for the overall project in 2013. *See*, Exhibit JCE-2, p. 7, line 113.

SJWC witness Lambing explained in rebuttal that “the primary driver for this project” is the required replacement of the MCC due to its unsafe and unreliable condition. Replacements and retrofits over the 49-year life of this facility leave inadequate space for SJWC electricians to work safely and replacement parts are difficult to find. A new MCC will provide improved system reliability, efficiency, and safety. For example, the new motor starter will offer enhanced protection against damage due to voltage and current fluctuations, and its soft stopping control will reduce the water hammer effect that can damage pipes, valves, and pumps. New electrical layout, cable connections, and cabinets all will enhance safety by limiting worker exposure to electrical hazards. DRA’s concern about recent reductions in water usage is not relevant to the safety imperative driving replacement of the MCC at Overlook Station. Exhibit SJW-10, ch. 7 (Lambing), at 7-13 to 15; *see also, id.*, photographs at 7-19 to 20.

Mr. Lambing further explained and justified the relocation of existing booster pumps proposed to accompany the MCC replacement at Overlook Station. Providing additional detail about the disparate elevation of the two tanks and the inefficient utilization of storage capacity that results from the present piping arrangement, he testified that it is cost-effective, when replacing the MCC, to relocate all the related pumping equipment to place the suction inlet for the pumps at the base of the lower tank, thereby increasing usable storage volume by 450,000 gallons, or about 35%. Here too, the recent reduction in system-wide water usage does not diminish the value of eliminating an existing operational deficiency that

threatens the supply of water to a higher elevation zone for both potable use and fire protection. As Mr. Lambing concluded, “performing the MCC replacement and pump relocation work as one project is the most cost effective approach to addressing the existing issues,” while minimizing construction-related disruptions for neighbors and customers. *Id.* at 7-15 to 17. In short, the full \$1,080,000 cost of improvements at Overlook Station should be included in the approved construction budget for 2013.

b. MCC addition and a second booster at Mireval Station.

Mireval Station has operated since 1963, providing the only source of water for an adjacent higher pressure zone, which in turn provides the only source of water to two higher pressure zones serving about 250 people in the foothills of Los Gatos. The pump station consists of one booster pump and an MCC. The aging MCC at Mireval Station is of the same vintage as the Overlook Station MCC and presents the same combination of problems – safety hazards for SJWC operators and electrical staff, unreliability to meet operational needs, maintenance issues due to the difficulty of finding compatible replacement parts, and a lack of efficient features of state-of-the-art MCCs. Exhibit SJW-3 (Lambing), at 105-06.

Here again, when looking to replace the MCC, SJWC also evaluated the related pumping equipment. In recent years, demand in the Cypress Zone, served by the single Mireval Station booster pump, has approached an observed production deficit – with at least 16 days where system demand exceeded 70% of total available production capacity of the Mireval booster. In addition, adequate production capacity must be available to provide timely recovery of the mandatory fire protection volume in storage. Calculating a current fire flow deficiency of 126 gallons per minute (“GPM”), SJWC concluded that installing a second booster at Mireval Stations with a capacity of at least 126 GPM would address both the maximum day demand and fire flow deficits. *Id.* at 106-07.

Considering the alternatives of doing nothing or continuing to replace individual components as needed, SJWC concluded that replacement of the MCC and addition of a second booster pump made better sense on grounds of operational efficiency and safety, minimal disruption of water service, and extended equipment asset life – especially considering the improved system reliability in both water service and fire protection with addition of the second booster pump. *Id.* at 108-09.

DRA's only challenge to the Mireval project is that SJWC's concern about 16 days in recent years of system demand exceeding 70% of available production capacity referred to the "recent years" of 2004 through 2008 and that overall demand is down 15% since 2007. Solely on that basis, DRA sees no need for a second booster pump at Mireval station at this time. Exhibit DRA-1, ch. 8 (Rasmussen), at 8-11. As in the case of Overlook Station, DRA offers not a word of criticism about SJWC's showing of need to replace the MCC at Mireval Station; nor does DRA say anything to refute SJWC's concern about the fire flow deficiency inherent in serving the Cypress Zone with a single booster pump at Mireval Stations. Nonetheless, DRA would disallow the entire \$939,000 investment proposed for the Mireval project in 2013. *See*, Exhibit JCE-2, p. 7, line 112.

Mr. Lambing's rebuttal testimony emphasized the observed production deficit approached by Cypress Zone demand based on comparing the observed and calculated maximum day demands to the production capacity of the single Mireval booster pump. He also restated SJWC's previous showing that the fire flow available to serve the Cypress Zone is deficient. Mr. Lambing noted as well, that the system-wide 15% usage decline referenced by DRA has not occurred in the Cypress Zone, where maximum day demand actually has increased slightly from 2009 through 2011. Exhibit SJW-10, ch. 7 (Lambing), at 7-20 to 23.

He also noted “the other driver for the work proposed at Mireval Station” – that being the need to replace the MCC due to its unsafe and unreliable condition. *Id.* at 7-23 to 25.

Mr. Lambing concluded that, for the reasons stated, SJWC believes the entire Mireval project to be prudent and necessary. *Id.* at 7-26. DRA has provided no evidence or rationale to support excluding this project from SJWC’s construction budget for 2013.

c. MCC replacement and pump relocation at Franciscan Station.

Franciscan Station, equipped with two boosters controlled by an MCC, is a critical relay facility that provides two of only three inputs for pumping water to the Montego Zone, which has 560 service connections serving more than 2,200 people in the Almaden Valley. Installed in 1966 when the station was constructed, the MCC at Franciscan Station is just a few years younger than those at Overlook and Mireval Stations. The same considerations discussed with respect to the MCCs at those stations apply to the MCC at Franciscan Station as well – safety hazards for SJWC operators and electrical staff, unreliability to meet operational needs, maintenance issues due to the difficulty of finding compatible replacement parts, and a lack of efficient features of state-of-the-art MCCs. Exhibit SJW-3 (Lambing), at 168-69. In addition, because the earthen reservoir at Franciscan station is no longer operational, the two boosters are provided suction head from the distribution system itself and experience low suction head during summer demand periods. Relocating the two boosters to a lower elevation will both increase capacity and eliminate the low suction head conditions that prevent efficient pumping at times of high summer demand. These upgrades and relocations are needed to provide operational flexibility and reliability for the Montego Zone. *Id.* at 168.

Considering the alternatives of doing nothing or replacing the MCC and relocating the two booster plants, SJWC concluded that the active approach was the superior alternative,

because it increases operational flexibility and reliability during summer demand periods as well as providing the safety benefits from MCC replacement noted above. *Id.* at 169-70.

DRA notes that the earthen reservoir at Franciscan Station has been out of service since 1985 and so the current “operating scenario is not a new one.” Given reduced overall consumption, DRA sees a reduced possibility of low suction head conditions at Franciscan Station. Exhibit DRA-1, ch. 8 (Rasmussen), at 8-12 to 13. DRA does not say what it proposes to do in the context of this allegedly reduced risk and again fails even to mention the proposed MCC replacement, but DRA in fact proposes to exclude from SJWC’s 2014 construction budget the entire \$1,235,000 cost of the Franciscan Station project. *See*, Exhibit JCE-2, p. 8, line 132.

Mr. Lambing’s rebuttal testimony again makes the point that DRA’s reliance on reduced overall consumption is an inadequate basis for not proceeding with the MCC replacement and the relocation of booster pumps at Franciscan Station. As he testified, the pump relocation addresses an existing operational deficiency that threatens the supply of water to the Montego Zone for both potable use and fire protection, and coordinating the MCC replacement with the relocation work is cost-effective and minimizes construction-related disruptions to neighbors and customers. Addressing DRA’s point that the hydraulic deficiency at Franciscan Station is not new, Mr. Lambing stressed that this fact does not diminish the value of the proposed booster relocation. He explained that SJWC endeavors to identify inefficiencies through interaction between system operators and engineers who prescribe solutions, observing that it “does not make sense that just because someone has been sick for a long time they should remain sick.” Exhibit SJW-10. ch. 7 (Lambing), at 7-26 to 27.

DRA has failed to provide any good reason for SJWC not to pursue the planned work at Franciscan Station. As Mr. Lambing concluded his rebuttal testimony, SJWC believes

the entire Franciscan Station project to be prudent and necessary. *Id.* at 7-27. The project cost should be included in SJWC's construction budget for 2014.

d. An additional booster pump at Buena Vista Station.

Buena Vista Station is a critical groundwater production facility that pumps water to the Cambrian and Dow pressure zones – the two largest zones in the SJWC distribution system, with a total of more than 82,000 service connections serving approximately 330,000 people. Originally constructed in 1913, Buena Vista Station includes eight wells, four booster pumps, and a related suction basin. Current well production capacity at Buena Vista Station is 22.8 MGD, while current booster pumping capacity is only 13.7 MGD, equating to a booster capacity deficit of 9 MGD. While it is desirable to maintain between 3 and 6 MGD of excess well capacity, the well capacity in excess of 6 MGD can be put to beneficial use. Exhibit SJW-3 (Lambing), at 171-72.

Due to regionally identified threats to the imported water supplies that SJWC acquires through SCVWD, SJWC's ability to call upon all available groundwater pumping facilities to meet demand is becoming increasingly important. As part of a continuing effort to provide a reliable water supply, SJWC has identified several groundwater facilities where the current booster pump to groundwater well deficit exceeds 6 MGD. Rectifying those situations offers SJWC opportunities to expand the use of readily available groundwater production capacity to meet system demands whenever imported supplies are limited or unavailable. As a facility serving SJWC's two most populous pressure zones, Buena Vista Station offers a key potential resource that can be most efficiently utilized by adding a single new booster pump with a capacity of 4 MGD. Considering the various scenarios where imported water supplies may be significantly reduced or lost completely for months or years at a time due to

Sacramento Delta water supply issues, this project, scheduled for 2014, will offer substantial benefits at a reasonable cost of \$885,100. *Id.* at 172-73.

DRA opposes SJWC's proposal to install an additional booster pump based on its review of daily production from Buena Vista Station from 2007 through 2011, which DRA found to present a declining trend. On that sole basis, DRA contends that a fifth booster pump is not needed at that station, and would disallow the proposed investment. Exhibit DRA-1, ch. 8 (Rasmussen), at 8-12 to 13; Exhibit JCE-2, p. 8, line 133.

In rebuttal testimony, Mr. Lambing explained that the downward trend in production at Buena Vista Station was due to "two relatively long periods of time [when] the station [was] off-line while [capital] projects were being constructed as well as a recognized decline in system wide demand." Exhibit SJW-10, ch. 7 (Lambing), at 7-27. He argued that regardless of the trend direction, making effective use of the groundwater resource is the primary objective of the Buena Vista Station project. Mr. Lambing affirmed the analysis presented in Exhibit SJW-3, noting that the recognized uncertainty about delivery of non-local water supplies through SCVWD makes it important for SJWC to make the best use of local supplies and be prepared to do so. In particular, threats to SCVWD's imported water supplies – especially due to challenges in the Sacramento-San Joaquin Delta – make it necessary to have the means to deliver local groundwater in place of the imported water that makes up nearly half of SJWC's annual water supply. *Id.* at 7-28 to 30.

Even without a major failure in the Delta, the need for groundwater during normal weather cycles is increasing. Mr. Lambing cited evidence (in SCVWD's 2010 Urban Water Management Plan) that there already is not enough water available to meet demand in years 5 and 6 of a six-year drought. SJWC's ability to call on all available groundwater pumping facilities to meet demand is becoming ever more important as the water supply picture becomes

less certain. This is the basis for SJWC's proposal to install a fifth booster pump at Buena Vista Station. Exhibit SJW-10, ch. 7 (Lambing), at 7-30 to 32. A temporary decline in production at this critical facility does not justify placing the security of water supply delivery capability to a population of approximately 330,000 people at risk. The \$885,100 investment budgeted for installation of a fifth booster pump at Buena Vista Station is prudent and necessary – and should be included in the capital investment plan approved for SJWC.

e. MCC replacement and addition of a booster pump at Miguelito Station.

Miguelito Station has operated since 1949, consisting of four booster pumps, an MCC, and two reservoirs. Two of the pumps convey water to the Alum Rock and Crothers Zones, serving about 730 service connections and a population of about 3,000 in the east hills of San Jose. The other two pumps are used to sustain pressure to support water deliveries to the upper portion of the Miguelito Zone. The 62-year-old MCC at Miguelito Station is even older than those at Overlook and Mireval Stations and presents the same combination of problems described in connection with those facilities – safety hazards for SJWC operators and electrical staff, unreliability to meet operational needs, maintenance issues due to the difficulty of finding compatible replacement parts, and a lack of efficient features of state-of-the-art MCCs. Exhibit SJW-3 (Lambing), at 177-78.

Considering the alternatives of doing nothing or continuing to replace individual components as needed, SJWC concluded that replacement of the MCC and addition of a fifth booster pump made better sense on grounds of operational efficiency and safety, minimal disruption of water service, and extended equipment asset life. Adding the proposed booster #5 will provide additional pumping capacity to meet maximum day demands in the area served. *Id.* at 178-80.

DRA recommends deferring the Miguelito project solely on the basis, that “the maximum day demand, last seen in 2007, is not projected to occur again in the near future with declining demand.” Exhibit DRA-1, ch. 8 (Rasmussen), at 8-13. As in the case of several other combined MCC replacement/pump addition projects, DRA does not address the MCC replacement proposal in any way. DRA would, however, disallow the entire \$1,360,000 investment proposed for the Miguelito project in 2014. *See*, Exhibit JCE-2, p. 8, line 134.

In rebuttal, Mr. Lambing testified that the two Miguelito Station booster pumps serving the Alum Rock Zone have been operating at the same flow rate for about 60 years, as operational demands on these pumps have gradually increased. Contrary to DRA’s reliance on recent decline in system average demand, usage in the Alum Rock Zone has not decreased to the same extent. Exhibit SJW-10, ch. 7 (Lambing), at 7-32 to 34. He also emphasized that the observed system-wide decrease in water usage is not relevant to the need to replace the old MCC cabinet and components in order to ensure reliable operations and to address employee safety issues. *Id.* at 7-34 to 35.

Mr. Lambing concluded that, for the reasons stated, the Miguelito Station project is prudent and necessary. *Id.* at 7-36. Certainly, the need for SJWC to replace the MCC at this location – as at other project sites – had been demonstrated and has not been rebutted. DRA has not justified excluding the Miguelito Station project from SJWC’s construction budget for 2014.

f. MCC replacement at Koch Lane Station.

Koch Lane Station was initially constructed in 1955 and now includes two wells, one booster pump, an MCC, and a suction basin. The pump serves the Dow Zone, with over 41,000 connections and a population of about 165,000. The 56-year-old MCC at Koch Lane Station presents the same combination of problems described above in regard to other MCCs –

safety hazards for SJWC operators and electrical staff, unreliability to meet operational needs, maintenance issues due to the difficulty of finding compatible replacement parts, and a lack of efficient features of state-of-the-art MCCs. Exhibit SJW-3 (Lambing), at 152.

Considering the alternatives of doing nothing or continuing to replace individual components as needed, SJWC concluded that replacing the MCC, at a cost of \$715,700, makes better sense on grounds of operational efficiency and safety, minimal disruption of water service, and extended equipment asset life. *Id.* at 153-54.

DRA claimed, as discussed above with respect to replacing the tank at Koch Lane Station, that this production facility has not been in operation since 2007. DRA recommends that Koch Lane Station not be restored in 2014 because “it is not required to meet current production amounts.” Exhibit DRA-1, ch. 8 (Rasmussen), at 8-14.

In rebuttal, Mr. Lambing explained that the Koch Lane Station currently is in “standby operation in order to routinely run the two wells and collect water quality samples required by the California Department of Public Health.” Exhibit SJW-10, ch. 7 (Lambing), at 7-36. In this context, the same considerations discussed above with respect to this and other MCC replacement projects support the need to replace the old MCC and its components in order to ensure reliable operations and to address employee safety issues. This project, to be conducted in 2014 in conjunction with the Koch Station tank replacement discussed above, is prudent and necessary. *Id.* at 7-37 to 38.

2. SJWC has specifically justified the installation and costs of standby generators at all the sites opposed by DRA.

SJWC prepared a detailed study entitled, “Emergency Power Program for Disaster Recovery,” which was completed in October 2011 and received into evidence as Exhibit SJW-

7. The study defines a level of service goal during natural disasters, which is:

to continue serving customers, immediately after a major earthquake, or other natural disaster, by self-generating sufficient emergency power for pumping equipment to produce enough water to satisfy the baseline customer usage.

Exhibit SJW-7 (Gere), at 1. This goal is consistent with guidance provided by the Commission's General Order 103-A and relevant DPH standards. *Id.* at 2-3.

The study assesses the adequacy of standby power generators at pumping stations to meet that goal, identifies existing deficits in the Company's capacity to do so, and makes recommendations for upgrading SJWC's standby power network with a six-year, \$11 million capital improvement program. Recommended additions include installation of eight stationary standby generators, ranging in capacity from 100 to 1,800 kilowatts ("kW"), to serve major pumping stations; eight smaller stationary generators, with capacity of 10 to 35 kW, to serve smaller pressure systems, and twelve 100-kW mobile standby generators to be purchased in 2012 plus another five in 2015. *Id.* at 1, 10-11; *see also*, Exhibit SJW-3 (Lambing), at 91-93 (mobile generators), 190-92 (Williams Road Station), and 193-95 (Tully Road Station).

DRA's testimony notes that SJWC proposes to include four of the large stationary generators and all eight of the smaller ones in its capital improvement program for 2012 to 2014, at a total proposed cost of \$5,324,000. DRA proposes to exclude part or all of SJWC's estimated costs for six of the facilities – those at Chablis, Columbine, Fleming, Varner Court, Tully Road, and Williams Road Stations, allowing a total budget of just \$1,712,700. Exhibit DRA-1 (Gandara), at 8-14, 8-18.¹⁷ For the first four of these facilities, DRA proposes a reduction in the estimated cost, based on sizing of the generator and quotes provided in

¹⁷ See Exhibit JCE-2, p.6, lines 96-98, and page 8, lines 135-37, for the differences between the parties on a project-by-project basis. DRA's proposal to exclude a portion of the estimated cost of the proposed mobile standby generators is addressed in Section IX.G, below.

discovery. *Id.* at 8-15 to 16. For the large stationary generators proposed for the Tully Road and Williams Road Stations, DRA would entirely disallow the estimated costs of \$1.4 million and \$1.7 million, respectively, claiming the generators are not needed because “[s]urplus water can be allocated from [surrounding] zones.” *Id.* at 8-16 to 17.

SJWC’s Chief of Operations, Andrew Gere, provided testimony rebutting DRA’s proposed disallowances. Each of the six affected facilities will be addressed in turn.

Mr. Gere explained that SJWC’s estimate of \$119,500 as the cost to install a stationary 10 kW standby generator at Chablis Station was correct and was not an estimate for the initially recommended 15 kW machine. Exhibit SJW-10, ch. 3 (Gere), at 3-15. DRA’s assumption to the contrary was mistaken.

Mr. Gere also stood by the Company’s estimates of \$466,600, \$424,400, and \$202,700 as the costs to install stationary 100 kW standby generators at Columbine Station and Fleming Station and a stationary 10 kW standby generator at Varner Station, respectively. He explained that Energy Systems Inc., whose lower quotes DRA reviewed, is an equipment vendor, not a general contractor, and DRA “apparently omitted or underestimated the construction cost” for the work required to install and activate the standby generator. *Id.* at 3-15 to 16.

Mr. Gere debunked DRA’s claim that it is feasible to avoid the need to provide standby power capacity at the Williams and Tully Stations by creating and storing surplus water in zones surrounding the Columbine and Cox Zones. DRA apparently ignored the premises of SJWC’s referenced Emergency Power Program report, Exhibit SJW-7 (Gere), that imported water is not available from SCVWD for one to two weeks after a natural disaster, groundwater is available, emergency distribution of that groundwater is necessary, and booster pumps must run at Columbine and Cox Stations to deliver that water to higher elevation zones.

Because SJWC produces groundwater only in its lowest elevation zones, it would not be possible after a natural disaster to create water in the higher zones. Nor are the reservoirs in higher zones designed to contain enough water to meet more than one or two days of consumer demand. Therefore, SJWC does not agree with DRA's concept of creating and storing surplus water in the upper zones, and reasserts the need to provide for emergency standby power at both Tully Road and Williams Road Stations. Exhibit SJW-10, ch. 3 (Gere), at 3-16 to 17; Exhibit SJW-7 (Gere), at 2.

Mr. Gere also rebutted DRA's criticism of the cost estimates for the projects at Tully and Williams Stations. As in the cases of the smaller-scale projects at other sites, DRA relied on quotes from ESI, an equipment vendor, and so "apparently omitted or underestimated the construction cost" for the work required to install and activate the stationary standby generators at these stations. Exhibit SJW-10, ch. 3 (Gere), at 3-17 to 18.

3. SJWC has fully justified its planned investments in Pump Stations and Equipment and DRA's criticisms of those projects do not stand up to scrutiny.

DRA provides a summary comparison of SJWC's estimates of capital investments for Pump Stations and Equipment during the years 2012 to 2014 and the amounts DRA proposes to allow for these purposes. As noted above, DRA's proposed disallowances exceed \$9.8 million. *See*, Exhibit DRA-1, ch. 8 (Rasmussen), at 8-18. As has been shown, DRA's reasoning for excluding the costs of six proposed pump station projects ignores the need to replace aging MCCs and fallaciously concludes that a few years of decline in average system sales makes it unnecessary to consider site-specific water conveyance needs. When presented on cross-examination with Mr. Lambing's reasons for replacing the MCCs, the DRA witness did not dispute that analysis and recognized the need to modernize the MCCs, but stated that projects including MCC replacements "were all lumped as projects together with other

improvements at [the] stations” which DRA opposed. Tr. 282:28-284:12 (Rasmussen/DRA). This truly appears to be a case of DRA allowing the tail to wag the dog.

Likewise, DRA’s opposition to six proposed stationary standby generators is based on two premises that SJWC has demonstrated to be false – first, that an equipment vendor’s quotes covered the entire cost of constructing several stationary standby generators and, second, that groundwater supply in a prolonged emergency could somehow be delivered from higher elevation zones surrounding the zones where groundwater is normally produced. In short, SJWC’s construction projects in the area of Pump Stations and Equipment are prudent and justified, and the Company’s proposed annual budgets for these projects should be approved.

E. SJWC’s Proposed Budgets for Distribution Plant Should Be Approved.

Several categories of utility plant in which SJWC has proposed substantial investment in the present GRC are in the area of Distribution plant – including mains for the delivery of recycled water, replacement mains, services, and meters. Construction budgets for these categories of plant investment for years 2012 through 2014 are summarized in Exhibit SJW-1A, Table 11-B and differences between the parties are listed in Exhibit JCE-2, p. 6, lines 99-102, p. 7, lines 114-19, and p. 8, lines 138-42.

1. The Commission should authorize SJWC to proceed with plans to construct mains during this GRC cycle for delivering recycled water.

Recycled water is a valuable new and underutilized drought-resistant source of supply. SJWC’s plans and program for deployment of recycled water pipeline infrastructure projects are presented in Chapter 20 of Exhibit SJW-1, sponsored by Mary Hoang, of HydroScience Engineers, Inc. (“HSe”), who has advised and assisted SJWC for a number of years in the development of its recycled water master plan for pipeline extensions and service

demand projections as well as on site consumer plumbing retrofit design. As indicated within SJWC's 2010 Urban Water Management Plan ("UWMP"), recycled water demand projections show an increase in recycled water as a percentage of SJWC's system supply and SJWC plans to rely on recycled water as an important means of serving state policies, including the Commission's own Water Action Plan that promotes water conservation and increased use of recycled water in California. Exhibit SJW-1, ch. 20 (Hoang), at 1-4.

Water agencies in Santa Clara County have partnered to develop infrastructure to support increased use of recycled water. SJWC, along with several South Bay cities, has entered into arrangements with the South Bay Water Recycling Program ("SBWR") to purchase recycled water produced from the San Jose/Santa Clara Water Pollution Control Plant. Since entering into a wholesaler-retailer agreement with the City of San Jose in 1997 to facilitate SJWC's retail sale of recycled water to its customers, SJWC has come to serve more than 60 recycled water customers, who used 1,208 acre feet per year ("AFY") of recycled water in 2010. The existing SBWR infrastructure has capacity to deliver 50,000 AFY, but currently the average demand is only 10,000 AFY (of which SJWC serves about 10%). *Id.* at 4-8.

With the assistance of HSe, SJWC has developed a Recycled Water Master Plan that provides a strategy to achieve the recycled water goals and serves as a basis for eligibility to receive Title XVI grant funding. The Master Plan includes planning criteria for developing recycled water project alignments, which are explained in Ms. Hoang's testimony. Of 18 alignments identified in the Master Plan, three were selected and approved by the Commission's D.09-11-032 in SJWC's last GRC for construction in years 2009 to 2011. Exhibit SJW-1, ch. 20 (Hoang), at 8-12. Seven alignments are proposed for construction in years 2012 to 2014, selected based on their unit cost and the ability to provide future

opportunities for groundwater recharge. Detailed information about these alignments is provided in Ms. Hoang's testimony. *See, id.* at 14-25 and Appendices A-D.¹⁸

DRA considers SJWC's proposals to invest in recycled water "over aggressive" and "20 years too early, based on the projected demand for recycled water for the same time period." DRA proposes to disallow \$25.84 million of the \$31.55 million SJWC proposes to invest in recycled water distribution mains over the years 2012 to 2014. DRA objects not only to these capital costs but also to SJWC's proposal to fund customer retrofits, which DRA criticizes as "a subsidy flowing from all SJWC ratepayers to 240 customers who are primarily commercial." Exhibit DRA-1, ch. 8 (Rasmussen), at 8-1 to 3.¹⁹

DRA recommends that the Commission authorize the four recycled water alignments proposed for implementation in 2012, amounting to an investment of \$5.7 million, in order to allow SJWC to meet its recycled water usage goal for 2015 as shown in the Company's 2010 UWMP, but DRA recommends deferring the remaining projects. *Id.* at 8-19, 8-30. Based on demand projections in the 2010 UWMP, DRA considers that the proposed construction budget for new recycled water mains "comes 20 years too early based on the projections for available customers to make use of those proposed new mains." *Id.* at 8-20.

¹⁸ Descriptions of the seven recycled water distribution alignments proposed for years 2012 to 2014 also are provided in SJWC's workpapers, including the construction budget for each project. Exhibit SJW-2A, WP 11-8, p. 6, items 4418-4421, WP 11-9, p. 5, items 4422-23, and WP 11-10, p. 5, item 3615. The five largest of these projects also are listed in Exhibit SJW-3 (Lambing), at 25, because that exhibit is limited to projects with budgets of \$500,000 or more. Table 4 in Ms. Hoang's testimony shows slightly smaller amounts for the seven alignments, because her budgets do not include annual cost escalations. Exhibit SJW-1, ch. 20 (Hoang), at 16.

¹⁹ The capital costs of the recycled water alignments DRA wants to disallow are listed in Exhibit JCE-2, at page 7, lines 114-15, for the two 2013 projects and at page 8, line 138, for the single project proposed for 2014. The customer retrofit costs, which SJWC proposes to recover as current expenses, are included in Conservation Program expense in Exhibit JCE-2, p. 3, line 28.

DRA also objects to SJWC's proposal to spend \$15.9 million as an O&M expense in 2012-2015 for customer retrofits, at \$40,000 to \$60,000 each. SBWR formerly funded such retrofits in order to decrease the amount of effluent released from the wastewater treatment plant to the Bay. Such funding is no longer available from SBWR but DRA sees no direct need for SJWC to take on this burden and opposes authorizing SJWC to do so absent a buy-in and cost-sharing by recycled water customers. *Id.* at 8-21 to 23.

On rebuttal, SJWC witness Curtis Lam, also on staff with HSe, responded to DRA's claim that SJWC is proposing to complete recycled water projects "20 years too early" based on the UWMP projections. Mr. Lam noted that DRA referred to data on a table in the 2010 UWMP that presented incorrect recycled water use projection data. Four other tables in the document had the correct version of this data at the time of the report. SJWC has already submitted the corrected projection usage table to the Department of Water Resources and the information provided by Ms. Hoang in Chapter 20 was corrected during testimony. As such, SJWC's proposal to construct seven additional recycled water alignments for 2012-2014 is consistent with projected recycled water use for 2015. Mr. Lam also noted that the the UWMP is not intended to serve as SJWC's primary planning document for recycled water. He urged DRA and the Commission to evaluate recycled water projects on their merits rather than solely by reference to an earlier, more general, planning document, the UWMP. He emphasized that the use of recycled water helps to offset potable water usage, providing an additional local supply of water to reduce impacts during dry periods. Exhibit SJW-10, ch. 6 (Lam), at 6-2 to 3.

Responding to DRA's reasons for recommending that only four of the proposed recycled water alignments be authorized, Mr. Lam testified that historic recycled water usage in

SJWC's service area has been flat, due in part to SJWC not having had the funds to build new recycled water mains or fund customer retrofits.²⁰ He explained the motives of potential customers, concluding that it is essential to have authorized funding available in order to generate interest of potential customers. *Id.* at 6-3 to 4. Likewise, without SJWC's leadership in funding retrofit work, "it is likely that few potential recycled water customers will plan, permit, design, fund, and construct systems to provide recycled water to their site." *Id.* at 6-5. Mr. Lam confirmed that it is common practice for recycled water retailers to pay for most such retrofits. As he testified, without this retrofit program, "SJWC would be constructing recycled water infrastructure that may be either stranded or underutilized for an indeterminate amount of time, which does not benefit SJWC or its customers." *Id.* at 6-7 to 9.

In summary, the Santa Clara Valley offers an excellent and appropriate platform to make recycled water a substantial element in the water supply portfolio of one of the larger Class A water utilities. In the context of a cooperative relationship with SBWR and other public agencies in the South Bay, SJWC is well positioned to continue constructing alignments by which to deliver an available supply of recycled water to customers able to use that supply as an alternative to scarce potable water. If the Commission is serious about its commitment in the 2010 Water Action Plan to "[p]romote water infrastructure investment" and to "[s]trengthen water conservation programs to a level comparable to those of energy utilities" and, in the context of those objectives, to pursue Action to "[i]ncrease use of recycled water,"²¹ then the Commission should encourage SJWC to assume a leadership role among Class A water

²⁰ Indeed, DRA witness Rasmussen acknowledged that industrial customers not within range of the authorized extensions of the recycled water distribution system will not be able to use recycled water. Tr. 265:21-266:14 (Rasmussen/DRA).

²¹ CPUC, 2010 Water Action Plan, October 2010, at 3, 7, 16.

companies rather than lagging behind other South Bay water retailers in the delivery of an available recycled water supply to customers who can put that supply to beneficial use and offset demand on potable supplies.

2. SJWC has shown the benefits of continuing to pursue a steady core program of 1% annual main replacements.

In its decision in SJWC's last GRC, addressing SJWC's proposed Pipeline Replacement Program, the Commission noted that it would be imprudent for SJWC to defer pipe replacement in favor of waiting for leaks to occur in an aging pipe system and that "to ensure that SJWC's ratepayers continue to receive reliable and quality water service and given the current age of SJWC's pipes, it is reasonable to adopt SJWC's Pipeline Replacement Program. D.09-11-032, at 31. The same decision required SJWC to provide "a full accounting of the findings and success of the accelerated replacement program as part of its next GRC." *Id.* SJWC provided the required accounting in Exhibit SJW-1, ch. 11, Attachment 1 (Tuttle).

In the present case, SJWC proposed to maintain its commitment to replace 1% per year of the Company's miles of pipeline. In order to normalize the long-term replacement rate for the linear infrastructure and maintain a good working pipeline network with minimal disruptions from leaks, SJWC needs to maintain the current annual replacement rate of approximately 24 miles of pipe, or 1% of the total pipe length in SJWC's service area. Exhibit SJW-3 (Lambing) at 14. A 1% replacement rate is needed to keep up with replacement of aging cast iron pipelines (up to 130 years old) and a large inventory of shorter lived thin-walled steel piping in SJWC's system. Exhibit SJW-1, ch. 11, Attachment 1 (Tuttle), at 1. Further, a 1% replacement rate is equivalent to a 100-year lifespan, which is equivalent to the actual weighted average life expectancy of all pipes in SJWC's system of 91.5 years. Exhibit SJW-1, ch. 11 (Jensen), at 2.

SJWC has shown that in order to maintain a good working piping network with minimal disruptions and leaks, the current replacement rate of 24 miles of pipe replacement per year must be maintained. If this does not occur, the average age of pipes in the system will increase to the point where there are a very high number of leaks in the system and pipeline infrastructure will be vulnerable to catastrophic failure in the event of a large earthquake or a severe drought. Exhibit SJW-1, ch. 11, Attachment 1 (Tuttle), at 4. A large number of leaks could cause many problems, including high incidents of boil water orders, safety issues at the locations of water main breaks, disruptions in traffic and water service, reduced firefighting capabilities, catastrophic coincidental failures in an earthquake, and many other potential issues. *Id.* at 11.

SJWC has analyzed the pipeline survivor curves for all classes and ages of pipeline in the system, and has determined that by equating failure rate with leak rate, it becomes immediately apparent by looking at each of the survivor curves that the leak rate for all piping types should be increasing dramatically in the near future. The only way to temper this is through the pipe replacement rate. As an example, as each legacy pipe is replaced with a new ductile iron pipe, the new pipe will follow the ductile iron pipe curve starting at age zero. Thus a higher replacement rate should lead to lower failures and leaks overall in the future. The projected failure rates will not change with the pipe replacement rate, but the pipe replacement rate will temper the effect of the aging piping by resetting the clock to zero for each pipe replaced. In fact, SJWC has shown that the average age of pipes in the system increases over time even at the 1% replacement rate, and would increase substantially at a 0.5% replacement rate. *Id.* at 7.

In addition to determining the appropriate replacement rate of 1%, SJWC performs detailed statistical analysis to establish a comprehensive replacement rank for all pipelines.

This analysis provides a decision-making tool to prioritize the replacement of higher-risk pipelines and to reduce the likelihood of catastrophic main breaks. SJWC's methodology provides a proactive approach to water main replacements because every pipe segment in the system is ranked based on specific and objective indicators. This tool aligns SJWC's resources to the mission of providing safe and reliable service and high-quality water to customers. Exhibit SJW-2 (Tuttle), at 2. In this GRC, SJWC has used this tool to help determine what specific pipelines should be targeted for replacement, which is then used to determine the appropriate construction budget for pipeline replacements. Exhibit SJW-2A, WP 11-8, p. 7-13, WP 11-9, p. 5-13, and WP 11-10, p. 5-13.

DRA argues that SJWC's main replacement program is too aggressive and believes that a less aggressive, more targeted, main replacement program could still replace enough mains to ensure reliability. Exhibit DRA-1, ch. 8 (Rasmussen), at 2. DRA recommends a replacement rate that is supported by an echo of replacement averaging 90 years, but distributed from 60 to 120 years. DRA feels this provides an annual replacement rate of 0.833%, or 20 miles of pipe. *Id.* at 42. In following its recommendation for replacement of 20 miles per year, DRA has deferred 4.5 miles of main replacement projects from 2012 to 3013, deferred then 9.4 miles of main replacement projects from 2013 to 2014, and removed a total of 14.4 miles of main replacement projects from 2014 to determine the recommended construction budget. *Id.* at 43.

DRA's analysis fails to account adequately for the fact that different vintages of SJWC's pipes have significantly different life expectancies and that, for about half of SJWC's pipes (steel pipe), the life expectancy is 70 to 85 years instead of the 90 year average. The 90 year weighted average is skewed somewhat by the fact that about a quarter of SJWC's pipe is ductile iron (which has an average life expectancy of 105 years) and are future replacements.

SJWC is an older utility with a significant amount of short lived steel pipes. Replacing 12, 16, or even 20 miles per year is not sufficient for safe and reliable service.

DRA witness Rasmussen acknowledged on cross-examination that SJWC is approaching a “peak of a replacement need,” due to the concurrent aging of the relatively short-lived steel pipe installed in the post-World War II era and the more long-lived iron pipe installed earlier in the 20th century, Tr. 267:15-268:14 (Rasmussen/DRA). Yet DRA recommends not accelerating the pace of pipeline replacement or even maintaining the previously authorized 1% annual rate, but instead recommends that SJWC “prepare for that peak that is approaching” by “tak[ing] a step back” and reducing the replacement rate to 0.83% per year. Tr. 268:14-269:13 (Rasmussen/DRA). That just doesn’t make sense.

The hypothetical pipe replacement rates and the current proposed DRA replacement rates yield the following average life expectancies of all pipes:

$$20 \text{ miles/year} = 120 \text{ years}$$

$$24 \text{ miles/year} = 100 \text{ years}$$

SJWC is proposing a 100-year replacement rate, the same replacement rate that was approved by the Commission in SJWC’s last general rate case, for pipes, close to the weighted average life expectancy of SJWC pipes of 91.5 years. Exhibit SJW-10, ch. 14 (Tuttle), at 3-4.

The need to continue with the Commission-approved 1% pipeline replacement rate has been shown in two ways. First, it was shown that since SJWC first began a concerted pipeline replacement program in late 2008, leaks have trended down despite the fact that every year all pipes age by one more year, increasing the average pipe age. SJWC’s current relatively constant leak rate is reflective of a combination of good operation and maintenance of an intricate system, combined with thorough pipe replacement planning. The second and perhaps more important point was demonstrating how, based on the lifespan and quantities of each type

of pipe in SJWC's system, the replacement rate should be at or above the 1% rate. Using the survivor curves specifically developed for SJWC's piping based on medium to long history of each pipe type (verified against national AWWA averages), the future failure rates were shown for both 12 and 24 miles per year replacement rates. These future failure rates were also shown for 16 and 20 miles per year pipe replacement rates. This analysis shows that even replacing pipes at 24 miles per year the average age of pipes will peak in the year 2069 at 58 years of age (half the pipe is older, half is younger). At a 12% pipe replacement rate, the peak isn't reached until 2169 with the average pipe age an astounding 104 years of age. At that point half of the pipe in the system would be well over the life expectancy and SJWC could not keep up with repairing leaks without significant staffing increases in the Distribution Systems Department.

It should be recognized that for a water utility of an age and with historical growth like that of SJWC, a pipe replacement rate representing the average life expectancy should be used. Therefore, for SJWC's pipeline system with about a 100-year life expectancy (weighted average is 91.5 years) and where about half of all pipe segments are shorter lived thin walled steel pipes that are quickly approaching the end of their life expectancy, a 1% replacement rate is prudent. Exhibit SJW-10, ch. 14 (Tuttle), at 4-5.

In response to cross-examination, Mr. Tuttle testified that with the spike in pipe installations in the 1950s and '60s, there will at some point be a corresponding spike in pipe replacement need and that SJWC can make the case for "an even stronger replacement program," but wishes to rely on a steady core program at the 1% pipe replacement rate. In fact, Mr. Tuttle saw a higher replacement rate as justifiable in the coming decade. However, he anticipated that SJWC "will be able to work with . . . a 1 percent rate. Rather than having fluctuations in the replacement rate through the years, this [1 percent rate] is the replacement

rate that is most prudent and has the fewest spikes in it, so we can best serve the customer.” Tr. 191:8-192:20 (Tuttle/SJWC). SJWC has well justified its proposed main replacement budget.

3. The budget for replacing services should match that for pipeline replacement.

An important part of the replacement of existing water mains is the replacement of the service lines that provide the connection from the main to the customer at the meter. These service lines are typically the same age as the pipe that is being replaced and it is very prudent to replace the service lines at the same time. The need for service line replacement and repairs is dependent on the pipe replacement rate and the number of service leaks that occur during the year. Therefore, replacement of services is an important part of the pipe replacement program and the repair and replacement of problem service lines are very important to ensure optimal service for SJWC’s customers. Exhibit SJW-3 (Lambing), at 27-29.

DRA recommends a reduced service line replacement budget that is in line with DRA’s recommendations related to SJWC’s Pipeline Replacement Program. Exhibit DRA-1, ch. 8 (Rasmussen), at 43-44. Although not stated in rebuttal, SJWC agrees with DRA’s position that the final service replacement budget should be set commensurate with the level of funding for the Pipeline Replacement Program.

4. In setting a budget for new and replacement meters, SJWC agrees with DRA that the number of recycled water meters should be commensurate with plans to install recycled water mains, but SJWC’s forecasted cost to replace Sensus meters is reasonable and DRA’s adjustments are unwarranted.

SJWC’s Distribution Systems – Meters construction budget consists of four components: (1) Annual purchase & installation of meters 2” and under; (2) Annual purchase of recycled water meters; (3) Annual purchase & installation of meters over 2”; and (4) Meter change out program for obsolete Sensus meters. Exhibit DRA-2A, ch. 11, WP 11-2, WP 11-8, p. 14, WP 11-9, p. 13-14, WP 11-10, p. 13.

DRA recommends that the budget for item (2), annual purchase of recycled water meters, be eliminated in years 2013 and 2014 in line with DRA's recommendation for no new recycled water mains in 2013 and 2014. Exhibit DRA-1, ch. 8 (Rasmussen), at 47. DRA recommends a reduced budget for item (4), meter change out program for obsolete Sensus meters, providing for a smaller number of obsolete meters than stated by SJWC and for eliminating any cost inflation factors. Exhibit DRA-1, ch. 8 (Gandara), at 45-48; Tr. 294:26-295:5 (Gandara/DRA).

Although not stated in Rebuttal, SJWC agrees that the budget level for recycled water meter purchases and installation should be set commensurate with Commission's findings on SJWC's recycled water mains budget.

Regarding item (4), meter change out for obsolete Sensus meters, the difference noted by DRA between the quantity of meters identified for replacement in Exhibit SJW-04 and the number identified in SJWC's response to DRA data requests is due to the timing of the data request in relation to the project implementation. The program had been in process for months prior to the data request, and the number of meters provided in the response was the number remaining to be replaced, not the total to be replaced at the beginning of the program. What DRA perceived as less than the originally requested quantity was due to the actual replacement of Sensus meters with Neptune meters. The scope of work defined in the GRC application for this project was accurate at the time as was the data provided in response to the data respective data request – and correctly estimates the total project investment required. Exhibit SJW-10, ch. 7 (Lambing), at 39-40.

Further, it has been and will continue to be prudent to apply a factor for inflation to capital improvement projects and equipment purchases as part of the GRC application. The cost basis for all the projects and equipment purchases in this GRC application are from the

middle of 2011, which was the time when SJWC was finalizing the budget for its Capital Investment Program. Looking forward three and a half years warrants consideration to factors that affect the value of money.

Meters and appurtenant materials are constructed from materials, such as copper, that experience price fluctuations due to market conditions. Costs for manufacturing and transporting the product also are affected by fluctuations in the cost of electricity and natural gas used to produce the material and in the cost of fuels for transportation.

Payroll costs as well as indirect labor costs such as payroll taxes, health insurance, and other benefits also increase with time. These cost increases not only are a factor in the process of manufacturing the meters but also affect the costs of the labor force that will be installing the meters. SJWC's burden on labor at the time of preparing the GRC application was 55.7%, while SJWC's current labor burden rate is 63.6%. The engineering and construction overhead rate also has been adjusted upward from the time of the GRC application from 8% to 9%.

Application of an inflation factor is a reasonable method for estimating future cost. Based on these real factors that impact the cost of Sensus meter replacement, like other capital projects, SJWC believes it is imprudent and unrealistic of DRA to segregate components of project cost to receive or not receive adjustment due to inflation. Exhibit SJW-10, ch. 7 (Lambing), at 40-41.

F. In the Area of Departmental Equipment, SJWC Has Justified Its Proposed Investments for the RIM Initiative and Other IT Projects.

The category of "Equipment" as included in SJWC's capital investment program is a broad class of investments in assets used and useful for various aspects of the Company's operations and administration within various of its operating and administrative departments.

The total investments proposed in this category amount to \$4,569,700 in 2012, \$3,952,300 in Test Year 2013, and \$3,590,500 in Escalation Year 2014. Exhibit SJW-1A, Table 11-B. As listed in the work papers providing Construction Budget Detail, the bulk of proposed Equipment investments are for the Information Technology (“IT”) Department – \$3,520,000 in 2012, \$3,745,400 in 2013, and \$3,394,100 in 2014 – with the only other Equipment classification exceeding \$200,000 being \$635,800 for the O&M Department in 2012. *See*, Exhibit SJW-2A, at WP 11-8, WP 11-9, and WP 11-10 Budget Summaries.²² The largest-scale specific project proposed in the Equipment – Information Technology area is Project 3885, for “Integration of Records Management Processes and Procedures,” which is budgeted at a level of \$1,416,200 in 2013 and \$1,464,400 in 2014. *Id.* at WP 11-9, p. 15, WP 11-10, p. 15.

1. The RIM Initiative is a high priority project aimed to achieve a well-managed records and information repository that serves efficiency, safety, and customer service goals.

A full description of Project 3885, also known as SJWC’s Records and Information Management Initiative or “RIM Initiative,” was provided in Exhibit SJW-3 (Lambing), at 39-43. The RIM Initiative is “a comprehensive, multi-phased, multi-year project that is intended to increase access to company records and information, reduce paper records, and ensure continued compliance and accuracy.” The Initiative “will facilitate timely system maintenance, quicken responses to SJWC customers, and promote continued public safety.” *Id.* at 39. SJWC intends to begin applying RIM policies using RIM technology in 2013. For the benefit of customers and for public safety, SJWC’s investment in its RIM structure will increase access to records and information, reduce paper records, and facilitate continued accuracy of records and

²² Specific budget items are listed under “Equipment” at WP 11-8, pp. 15-24, WP 11-9, pp. 14-17; and WP 11-10, pp. 14-16.

continued legal and regulatory compliance well into the future. *Id.* at 41. The lack of such programs is currently a source of great concern and attention for the Commission with respect to other regulated utilities.

The capital component of the RIM initiative will allow SJWC to store electronically many types of company records and information, comply with data and discovery requests and with retention laws and regulations more efficiently, achieve fast retrieval of and better access to records and information; and limit inconsistencies and misplacement of records and information. *Id.* at 40.²³

DRA considers SJWC a “particularly high tech water company,” and is concerned by a project as large as the RIM Initiative “on the heels of multiple other high tech initiatives.” complains of a lack of comparisons to other options for improving SJWC’s records and information management, and does not see the RIM Initiative as a high priority, particularly given the “high demand” for infrastructure improvements, and for these reasons recommends that the costs of the RIM Initiative be disallowed. Exhibit DRA-1, ch. 8 (Rasmussen), at 8-51 to 52.

In rebuttal testimony, SJWC witness Willie Brown emphasizes that DRA fails to consider the RIM Initiative’s immediate and long-term benefit to ratepayers and to the safety of SJWC’s water system. Investment in RIM is high priority to SJWC because this investment will greatly enhance efficiency and the use of data related to physical infrastructure. The development, implementation, and maintenance of an enhanced RIM structure are imperative

²³ SJWC’s RIM initiative includes an expense component of approximately \$200,000 per year related to consulting services, employee training, policy and procedures updates and implementation, technology administration, software maintenance fees, and the ongoing management of RIM software. *Id.* at 4. These expenses are addressed in Section VII.E.1 of this opening brief.

for SJWC to ensure that its record repository is accurate, easily accessed, organized, and secure and to increase the safety of its water system. SJW-10, ch. 1 (Brown), at 1-2.

Recent circumstances related to the tragic 2010 San Bruno incident underscore the need for public utilities to maintain streamlined and accurate records and information repositories that are easily accessible. In March 2012, in response to the San Bruno incident, the Commission's Consumer Protection and Safety Division ("CPSD") published a report finding that PG&E's recordkeeping practices prior to the incident were a major source of risk. The CPSD's report found that PG&E lacked some of the very RIM elements that are included in SJWC's RIM Initiative. These elements include: a strategy for records management; records management practices and processes that are verifiable, documented, communicated and available to all; complete and accurate records of the organization; a record-keeping program compliant with applicable laws and business requirements; the ability to retrieve records accurately, efficiently, and in a timely manner; and education and training in records management available and compulsory for all staff. *Id.* at 2.

While DRA notes that SJWC is technologically sophisticated and uses advanced technology related to its distribution system and customer service system, these uses of technology are limited to specific water system and business functions. This fact confirms SJWC's need to purchase and implement an electronic document/records management system ("EDRMS") to enhance its electronic recordkeeping practices across its entire records and information repository. An EDRMS solution will greatly increase the accuracy, accessibility, security, and regulatory compliance of SJWC's records and information repository. *Id.* at 3

The goal of RIM Initiative goal is a well-managed records and information repository that provides efficient response times to ratepayers and for upkeep, maintenance, and safety of the water system. SJWC, like many other companies, faces exponential growth of

unstructured electronic and paper data facilitated by desktop software and business systems. Proliferation of data without proactive investment, thoughtful planning, and effective management threatens to turn SJWC's information base into a significant liability that may harm its ratepayers. Unmanaged data growth will only exacerbate time-consuming searches, the risk of inaccurate and inaccessible records, and ultimately compromise the safety of SJWC's water system. *Id.* at 4. To enable SJWC to meet its goals of increased water system safety and a records and information repository that is more accurate, more accessible, and more secure, the Commission should recognize that the Rim Initiative is, in fact, a high priority, and should allow the estimated capital costs and operating expenses related to SJWC's RIM Initiative.

2. Other IT Equipment investments will enhance the efficiency of SJWC's operations.

Apart from the RIM Initiative, DRA takes issue with three additional projects in the Equipment category: a total station survey instrument in the Commercial and Field Service Department (\$66,000 in 2012) and two projects in the IT Department: 1) a viability study for automated metering infrastructure ("AMI") (\$233,000 in 2012); and 2) a workforce management system for the customer service call center (\$87,000 in 2012). Exhibit DRA-1 (Rasmussen), at 8-49; *see also*, Exhibit SJW-2A, ch. 11, WP11-8; Exhibit JCE-02, p. 6, lines 102-04.

DRA notes that SJWC's request to purchase a new total station survey instrument was justified as "increas[ing] the delivery rate of field survey data to meet design workload." DRA would disallow this purchase as consistent with its recommendation for fewer new (recycled) and replacement mains than proposed by SJWC. Thus, if the Commission does not go along with DRA's proposed drastic cuts in construction plans for recycled water and

replacement mains, then funds should be allowed to buy this “station survey instrument.” *Id.* at 8-50.

DRA justifies denying the AMI viability study and the call center workforce management system on grounds that AMI technology is still in its infancy and customer satisfaction with SJWC’s service is generally high. For these reasons, DRA sees no value in either of these purchases. *Id.*

The level of pipeline replacement and recycled water pipeline extension work is not the critical reason for the addition of survey equipment. Work conducted by the engineering department’s survey group, although primarily focused on topographic survey and base map development for the pipeline replacement program, includes work for many other types of projects as well. Other demands for the survey group include data collection and map preparation for special facilities projects (tanks, wells, pumping plant, etc.) as well as SJWC’s Water Service Engineering staff. As Mr. Lambing explained in rebuttal testimony, the additional survey equipment has been purchased and is already in beneficial use by SJWC survey staff, allowing for more efficient operations . Exhibit SJW-10, ch. 7 (Lambing), at 42. Since this equipment has already proven its worth in actual use, SJWC recommends the Commission allow this capital expenditure.

DRA justifies denying the AMI viability study and the call center workforce management system on grounds that AMI technology is still in its infancy and customer satisfaction with SJWC’s service is generally high. For these reasons, DRA sees no value in either of these purchases. *Id.*

SJWC’s AMI Study is intended to to build on the actual project experience of water AMI implementation by the San Francisco Public Utilities Commission, as well as other AMI experiences, to develop and quantify a model of conditions and results of implementation to

use as a “hurdle” or “test conditions” that will be met to consider AMI for SJWC. Exhibit SJW-10, ch. 2 (Drysdale), at 10. This Study also would investigate impact of AMI on water supply and energy requirements. Contemporary AMI systems include the capability for consumers to view water usage by time of day so customers can understand the impact water use patterns are having on both water and energy needs. Consumers considering whether to irrigate outdoor plants during times when evaporation loss is high and/ r peak energy is being used to move water through SJWC’s system, if informed, may choose to shift water use to a different time or day when evaporation and energy costs are lower. *Id.* at 12.

There are significant costs of failing to plan for AMI. Replacing large quantities of meters without considering a a long-term AMI plan presents a lost opportunity. The largest cost of AMI implementation is typically installation of the AMI unit in the meter box, and the easiest time to install is during meter replacement. SJWC replaces approximately 10,000 meters per year. There will be additional cost involved should these meters need to be replaced by AMI before the end of their useful life. Creative approaches, including technology sharing with PG&E and hybrid AMR/AMI plans, may take years to develop. Even if the viability study indicates that conditions are not perfect for AMI today, it is very likely, with changes in labor, water cost, energy cost, and good water use as either a desirable behavior or mandated policy, that AMI will be a viable solution in the next few years. The viability study will identify the sunk costs of failing to implement today, as well as the cost benefit and customer service benefit of implementing AMI, and will solve for conditions that are optimal for AMI implementation and their timing. *Id.* at 12 An independent AMI viability study is the best way to determine all the costs and benefits relevant to SJWC’s customers and operations, and, with data available today from many gas and water distribution AMI networks, this is the appropriate time to proceed with the study. *Id.* at 15

SJWC's Workforce Management System will enable SJWC to reduce manual work by Customer Service Supervisors, freeing time to resolve more challenging customer service situations promptly and accurately and to enable better monitoring and training of call center staff. The Call Center Management System is a key tool to measure customer service performance, identify potential problems in the call center, and, adjust work schedules, including overtime, number of agents on shift to meet call volumes. *Id.* at 15-16. This software purchase will enable SJWC Customer Service Supervisors to return several hours per day to their prime function, which is to assist water utility customers. *Id.* at 17.

Proposing to disallow the four projects noted above, DRA would allow only \$8,845,900 for Equipment purchases over the years 2012 to 2014, in contrast to SJWC's estimate of \$12,112,500. *Id.* at 8-52; *see also*, Exhibit JCE-2, p. 6, lines 102-04, p. 7, line 120, and p. 8, line 143. SJWC has demonstrated that the referenced projects should be pursued, and so the related Equipment is required.

G. SJWC Has Justified Purchasing 12 Mobile Standby Generators.

As discussed above in the context of Pump Station Equipment, SJWC prepared a detailed study entitled, "Emergency Power Program for Disaster Recovery," which was received into evidence as Exhibit SJW-7. The study assesses the adequacy of standby power generators at pumping stations and makes recommendations for upgrading SJWC's standby power network with a six-year, \$11 million capital improvement program. Recommended additions include installation of 16 stationary standby generators, ranging in capacity from 10 to 1,800 kilowatts ("kW"), to serve pumping stations of various sizes and complexities and twelve 100 kW mobile standby generators to be purchased in 2012, plus another five in 2015. SJWC also proposes to install a permanent 400 kW standby generator at its Taylor Street office. Exhibit SJW-7 (Gere), at 1, 10-11; *see also*, Exhibit SJW-3 (Lambing), at 91-93

(mobile generators). Plans and costs for the stationary standby generators at pumping stations were discussed in Section IX.D.2, above, but the mobile standby generators and the proposed Taylor Street installation are addressed here.

As stated in Exhibit SJW-3, the twelve 100 kW mobile standby power units, will be used to energize various SJWC booster pumps after an earthquake, wildfire, severe winter storm or other natural disaster, when normal PG&E electric power is lost for an extended period. SJWC has 33 booster pumps serving in small and mid-size residential zones that can be provided emergency power back-up more efficiently by these mobile units than by stationary installations and for longer durations than enlarged local reservoirs could provide. The total cost to SJWC of purchasing the twelve mobile units in 2012 is estimated to be \$1,936,000. This equipment is the means best suited to ensure that SJWC can continue to serve all customers with a baseline quantity of water and maintain the minimum water pressure required by DPH regulations during an extended power outage. Exhibit SJW-3 (Lambing), at 91-93; *see also*, Exhibit SJW-7 (Gere).

DRA does not question SJWC's need for the twelve mobile generators, but disputes the estimated cost. DRA cites a quote from Energy Systems Inc. ("ESI") to SJWC of a cost of \$723,000 for all twelve mobile generators and accessories, not including various associated costs that DRA claims justify a total cost estimate of just \$816,000 – excluding permit or contracting costs, with which DRA states that it “does not agree.” Exhibit DRA-1, ch. 8 (Gandara), at 8-53; *see also*, Exhibit JCE-2, p. 6, line 106.

Mr. Gere explained in rebuttal that ESI based its proposal on providing eleven mobile generators with Tier 3 exhaust emission controls and one mobile generator with Tier 4 controls, structuring the proposal in this manner to assist SJWC in researching and comparing costs. Because the Bay Area Air Quality Management District is expected to enact new

regulations in 2013 requiring Tier 4 exhaust emission controls on mobile generators, SJWC's full project cost estimate provides for equipping all twelve mobile generators with Tier 4 exhaust emission controls. Mr. Gere further noted that the project cost covers not only the twelve mobile generators but also construction of a reinforced-concrete parking pad and an electric trickle charger for the on-board batteries, needed to store the emergency equipment trailers in a state of readiness. These additional project elements justify the Company's full estimate of \$1,936,000 for this essential project. Exhibit SJW-10, ch. 3 (Gere), at 3-18.

SJWC also proposes to install a stationary 300 kW emergency generator on the premises of its office building at 30110 West Taylor Street in San Jose, at a cost of \$491,200 in 2013. This generator will provide power to the office so business can continue in the event of a loss of PG&E power. *See*, Exhibit SJW-2A, at WP 11-9, p. 19, item 4337.

Based on review of ESI's "budgetary pricing," DRA claims that a quote was provided for a 400 kW generator "with all accessories" at a cost of \$239,000. On this basis, DRA recommends allowing the purchase and installation of the generator at a cost of \$325,300 (just about 2/3rds of SJWC's estimate). Exhibit DRA-1, ch. 8 (Gandara), at 8-54; *see also*, Exhibit JCE-2, p. 7, line 123.

In rebuttal, Mr. Gere defended SJWC's estimate of \$491,200 as correct. He explained that ESI, whose lower quotes DRA reviewed, is an equipment vendor, not a general contractor, and DRA "apparently omitted or underestimated the construction cost" for the work required to install and activate the standby generator. That work includes having a general contractor excavate, build a concrete foundation, and set the equipment, having an electrical contractor install conduit and pull cable to the building's electrical control panel, and installing an automatic transfer switch and make major wiring changes within the control panel. The Company's project estimate of \$491,200 is appropriate.

H. The Evidence Supports SJWC's Proposed Budget for Vehicles.

SJWC has always taken a prudent approach in managing and maintaining its vehicle fleet, employing various fleet management systems to govern fleet operations, as described in Exhibit SJW-3 (Lambing), at 32. While industry standard for use of sedans and light duty vehicles is five years, SJWC extends this by two years to maximize the lifecycle value of each vehicle. *Id.* The Company plans to replace 19 high-mileage vehicles and trucks in 2012 at a cost of \$705,500, 26 in 2013 at a cost of \$1,063,800, and 13 in 2014 for \$1,403,800. Exhibit SJW-2A, at WP 11-8, p. 24, item 181, WP 11-9, p. 17, item 181, WP 11-10, p. 16, item 181. In addition, the Company plans to buy six trucks in 2013 to provide vehicles for new staff. *Id.* at WP 11-9, p. 17, item 182.

DRA applies the State Department of General Services' vehicle replacement policy, which treats vehicles as eligible for replacement after eight years or 120,000 miles, and on that basis determined that in 2012 twelve vehicles were eligible for retirement, at a combined replacement cost of \$306,510. Similar analysis resulted in estimates of \$311,930 for 2013 and \$478,975 for 2014. Because DRA would disallow all but three new employee positions SJWC has added or proposes to add over the four years 2011 to 2014, DRA would not provide any allowance for vehicles for new employees. Exhibit DRA-1, ch. 8 (Gandara), at 8-54 to 57; *see also*, Exhibit JCE-2, p. 6, line 105, p. 7, lines 121-22, and p. 8, line 144.

Mr. Gere provided SJWC's rebuttal to DRA's proposal to disallow most of the estimated cost for purchase of vehicles. He explained that the vehicles SJWC has scheduled for retirement have superseded the Company's guidelines of seven years or 100,000 miles, but that the tough and unforgiving conditions in the nature of the utility business cause SJWC's vehicles to accumulate most of their miles driving short intervals visiting multiple jobsites, which generate excessive wear and tear on mechanical components and vehicle interiors. A

replacement policy of 8 years/120,000 miles versus 7 years/100,000 miles incurs increased operating and maintenance costs and reduces resale value. Exhibit SJW-10, ch. 3 (Gere), at 3-19 to 21.

Mr. Gere also objected to DRA's use of the Manufacturer's Suggested Retail Price ("MSRP") to determine replacement costs in the case of trucks and vans. Because utility trucks require very specialized outfitting, MSRPs for comparable units are not readily available and DRA's drastic reduction in per unit costs and overall funding "clearly demonstrates that the DRA did not take into consideration the costs associated with building out specialized utility vehicles," which range from 10 to 200% above the base cost of the vehicle. SJWC has extensive experience in specifying job-specific utility trucks, and applied that experience in developing accurate cost estimates for all fleet purchases. *Id.* at 3-21 to 22.

Mr. Gere also confirmed SJWC's need for six additional vehicles in the event that the six new positions (Construction Aide, two Cross Connection Inspectors, Water Quality Inspector, Cross Connection Supervisor, and Water Quality Supervisor) are approved. There is no surplus of vehicles available for these new positions. *Id.* at 3-22.

I. SJWC Has Proposed Two Green and Alternative Energy Projects That Will Benefit Customers While Reducing SJWC's Need for Power From the Grid.

SJWC is requesting funding in 2014 for two "green" alternative energy projects. One is a proposal to install a ground-mounted array of photovoltaic ("pV") panels to generate 612 kW of solar energy at Williams Road Station #1, and the other is for a micro-hydro turbine generator energy recovery system to be installed at the Alum Rock turnout. The motivation for these projects is the Commission's Water Action Plan's encouragement to the Class A water

utilities to reduce their energy consumption by 10% over three years.²⁴ Because SJWC has become highly energy efficient over the past two decades, SJWC must turn to self-generation of electricity to further reduce its demand and consumption of electricity from the public grid.. Exhibit SJW-3 (Lambing), at 155.

DRA objects to SJWC’s reliance on the Water Action Plan, claiming that the energy use reduction goal of the Water Action Plan “should not be construed to imply any such goals for water utilities related to energy *generation*.” Exhibit DRA-1, ch. 8 (Rauschmeier), at 8-58. DRA agrees that SJWC “has already made significant strides in energy efficiency,” but argues that this does not justify now pursuing energy production projects “at all costs.” DRA notes that the 2005 Water Action Plan does not mention solar panel or hydro turbine installations, but only references improving the energy efficiency of existing operations. DRA acknowledges, however, that the 2010 Water Action Plan does – in the context of the Water/Energy Nexus program – encourage water utilities to reduce their power costs “by self-generation of energy using renewable energy sources.” Exhibit DRA-1, ch. 8 (Rauschmeier), at 8-59, referencing 2010 Water Action Plan, at 19.

DRA offers the obvious point that the Water Action Plan’s “broad mention of support should not be construed to imply support of every green/alternative energy project proposed.” Exhibit DRA-1, ch. 8 (Rauschmeier), at 8-59. Indeed, every utility construction project should be – and is – reviewed critically to determine that it will serve the interests of the utility’s customers. As SJWC will show its “green” energy projects pass that test.

In addition, as SJWC witness Gere testified, SJWC is proposing its two renewable energy projects to further the policy and statutes of the State of California that call for

²⁴ CPUC, Water Action Plan, adopted December 2005, at 10-11.

substantial reductions in greenhouse gas emissions and the provision of 33% of electricity demand in 2020 from renewable sources. The Commission's 2010 Water Action Plan specifically encourages Class A water utilities to develop renewable energy to reduce power costs. Exhibit SJW-10, ch. 3 (Gere), at 3-22 to 23. This is just what SJWC seeks to do.

1. The solar pV project at Williams Road Station will satisfy on-site power needs with a 13-year payback.

The Williams Road Station consists of two adjacent stations (#1 and #2) with a total of 15 wells and five booster pumps. Station #1 itself is a large property with an electrical energy draw so high (a 5-year average of 2,274,000 kWh) as to make it an ideal candidate for a large ground-mounted pV system. The project designer forecasts annual generation of 977,000 kWh, with SJWC consuming all the electricity generated through a standard net metering agreement with PG&E. Favorable features of the project include:

- Conforming to state policy (the Commission's Water Action) in reducing energy consumption;
- Providing a reliable source of renewable energy, consuming no fuel;
- Advancing the goal of national energy independence;
- Reducing SJWC's energy demand by 612 kW;
- Sparing the environment 278 tons/year of greenhouse gas emissions;
- Requiring low maintenance for pV panels and electronic inverters;
- Offering a 25-year life expectancy; and
- Helping stabilize PG&E's grid during high-demand summer days and reducing the risk of rolling blackouts.

Additionally, the project will qualify for incentives under the California Solar Initiative, the Federal stimulus law, and accelerated Federal tax depreciation. Exhibit SJW-3 (Lambing), at 155-56.

SJWC considered other sites for this project but found none of them to be as attractive as Williams Road Station #1, because the property is large enough to accommodate a 612 kW array, relatively few obstructions, the facility at this location will be eligible for PG&E's Tariff A6, which offers the best compensation, with the net metering rules compensating SJWC for power production at the on-peak retail rate while the plant runs during off-peak hours at lower charges. The estimated project cost in 2014 is \$3,424,600, but SJWC's financial evaluation demonstrates a 13-year payback. Exhibit SJW-3 (Lambing), at 156-59.

DRA opposes the proposed solar pV project, asserting that SJWC has not developed a "least-cost energy efficiency comparison" to justify it. DRA also claimed that SJWC has not confirmed that its Columbine pilot solar pV program can meet or exceed its designed performance. According to DRA, "the benefits to ratepayers are still unclear," with a payback period of 24 years to generate net savings to ratepayers. With an expected lifetime of 25 to 40 years for the Columbine project, DRA sees this as not an attractive investment from the perspective of ratepayers.. DRA recommends that the Commission, as it did in the last GRC, "give greater weight to capital investments in water supply and reliability for this GRC cycle." Exhibit DRA-1, ch. 8 (Rauschmeier), at 8-60 to 62, *citing* D.09-11-032, at 16.

2. The Hydro-turbine project at Alum Rock turnout will convert otherwise wasted hydro-power into electric sales to PG&E.

SJWC's proposed hydro-turbine project would require an expenditure of \$464,600 to install a 75 kW micro-hydro-turbine generator energy recovery system at Alum Rock turnout in 2014. Exhibit SJW-2A, at WP 11-10, p. 17, item 3703.

DRA points out that the Alum Rock turnout site has no pump, wells, or other equipment requiring electricity. Therefore, DRA argues, there is no direct way for SJWC to use the energy generated, as is the case with SJWC's previously authorized hydro-turbine

facility at Cox Avenue Station. Exhibit DRA-1. ch. 8 (Rauschmeier), at 8-62 to 63. DRA notes Commission policy favors hydro-turbine projects that directly benefit the utility and ratepayers in providing quality and reliable water service while reducing purchased power consumption over those that do not. *Id.* at 63, *citing* D.09-11-032 (Conclusion of Law 12). With no power-using equipment located at the turnout, DRA sees the proposed hydro-turbine project as one that should not be given priority. Exhibit DRA-1. ch. 8 (Rauschmeier), at 8-64.

Mr. Gere explained in his rebuttal testimony why it makes sense for a water utility to develop renewable energy projects, for three primary reasons:

First, when a water utility develops a renewable energy project, there may be no need to purchase additional property, thereby reducing project costs. Thus, SJWC already owns William Road Station, a 12.5 acre parcel with booster pumps and well pumps spatially separated to prevent interaction as required by DPH regulations. Solar panels for the proposed project can be accommodated within those open spaces. Similarly, the Alum Rock turnout was built on an easement from SCVWD, large enough to accommodate the proposed hydro-turbine project.

Second, water utility project sites may facilitate power distribution with only minor transmission line losses. Thus, Williams Road Station is located in a fully developed residential neighborhood within a mile of a bustling business district. Likewise, the Alum Rock turnout is in a fully developed residential neighborhood near a high school and several retail businesses. All the power generated by the two projects would be delivered for use by local businesses and residents, with only minor transmission losses.

Finally, both projects would generate electricity during on-peak periods, when PG&E needs it most and when, through net metering for the Williams Road Station and an

standard power purchase agreement for the Alum Rock turnout project, SJWC will be well compensated for its energy deliveries. Exhibit SJW-10, ch. 3 (Gere), at 3-23 to 24.

Mr. Gere testified that the renewable energy projects provide direct benefits to ratepayers, both by a reduction of approximately \$306,000 in annual operating costs for the next 25 to 40 years and by improvements in local air quality due to elimination of 420 metric tons of greenhouse gases every year. Strictly in revenue requirements terms, Mr. Gere confirmed that DRA and SJWC concur that both projects, with life expectancies of 40 years, are cost-beneficial – SJWC calculating a 13 year payback period while DRA states 24 years. *Id.* at 3-25. And, in fact, as Mr. Gere demonstrated, both the Columbine Station pilot solar project and the Cox Station hydro-turbine project have proven cost-beneficial. He concluded that “SJWC has already successfully integrated two existing renewable energy generators into its overall operation. The proposed renewable energy projects are similar to those existing generators.” With its proven track record of operating and maintaining solar and turbine generators, SJWC’s experience “makes the two proposed projects a wise investment.” *Id.* at 3-26.

X.

OTHER ISSUES RELATING TO RATE BASE

A. With Correction of an Error in the Salvage Rate, SJWC’s Proposed Depreciation Rate, Expense, and Reserve Are Properly Calculated.

SJWC has determined annual depreciation accruals by preparing annual depreciation studies and computations to reflect current weighting among ages, classes and types of depreciable properties, and their future life expectancies. Composite average lives of each property group were determined by "Average Service Life Weighting" in compliance with the Commission’s Standard Practice U-4-W. Depreciation accruals for 2012-2014 are based

upon the depreciation study performed for 2011 adjusted for the budgeted additions, estimated retirements, sales and adjustments for each year. Based on these depreciation studies SJWC's recommended composite depreciation rate for the Test Year 2013 is 3.51%. Exhibit SJW-1, ch. 12 (Lynch), at 1-2.

DRA recommends a composite depreciation rate of 3.46% based on adjustments to SJWC's depreciation work papers to account for errors submitted in the original January filing and acknowledged by SJWC in response to data requests. DRA further recommends decreasing the retirement component of the depreciation reserve forecast to align with the historical relationship between retired plant removed from ratebase and retired plant added to the depreciation reserve. DRA bases this adjustment on the divergence between the retirements shown for utility plant in service and for calculating depreciation reserve. Exhibit DRA-1, ch. 9 (Rauschmeier), at 3. As discussed above, SJWC acknowledged an error in the depreciation study submitted with the January filing relating to transportation depreciation. The error identified related to the salvage rate listed for Transportation Equipment. The salvage rate provided in the Application was 0.20% and was based on a preliminary Depreciation Study prepared in the Fall of 2011. The rate provided during discovery, and subsequently included in SJWC's final Depreciation Study submitted to the CPUC, was 19.20%. DRA's composite depreciation rate is based solely on revising this salvage value, and not including other adjustments made in the final analysis for depreciation reserve submitted to the Commission. However, due to the timing of the filing versus when the Application was prepared, the depreciation study submitted in the January filing was prepared in September 2011 and thus did not include full year-end numbers. Exhibit SJW-2, Ch. 12, at WP 12-7. On April 2, 2012, SJWC submitted to DRA the analysis of reserve for depreciation – 2011 (based on year end final balances), which determines the depreciation accrual for 2012. This schedule shows that

the beginning of year depreciable plant was \$1,000,300,175 and the depreciation accrual was \$35,009,426, which yields a composite rate of 3.50% for 2012. This composite depreciation rate, which is based on actual full year-end values, provides the most accurate composite depreciation rate for forecasting purposes. Exhibit SJW-10, ch. 9 (Lynch), at 7.

The divergence between retirements for utility plant and for depreciation reserve is due to what is included in retirements for utility plant and what is included for depreciation reserve. The \$2,100,000 included for utility plant in fiscal years 2012-2014 is only the cost of removal whereas the \$6,114,600 included for depreciation reserve includes both the cost of removal and the retired plant's service value. This is the appropriate treatment for depreciation reserve, as the Uniform System of Accounts for Water Utilities, Balance Sheet Accounts, Section X. Reserves, Paragraph B, page 32 states: "At the time of retirement of depreciable utility plant in service, this account shall be charged with the book cost of the property retired and the cost of removal, and shall be credited with the salvage value and any other amounts recovered, such as insurance." Thus, the calculation for depreciation reserve should not be adjusted, as it is in compliance with the Uniform System of Accounts for Water Utilities. Exhibit SJW-10, ch. 9 (Lynch), at 8.

B. SJWC Has Calculated Its Allocation for Cash Working Capital in Full Compliance With Standard Practice U-16-W.

For ratemaking purposes, the Commission allows the inclusion of amounts invested in working capital as an addition to rate base. Working capital consists of materials and supplies and working cash. The largest component of working cash is the average deficiency as a result of paying expenses, taxes and accrued depreciation in advance of collecting revenues. This component is calculated utilizing a lead-lag study. SJWC calculates working

cash based on the procedures outlined in CPUC Standard Practice U-16-W – Determination of Cash Working Allowance. Exhibit SJW-1, ch. 13 (Jensen), at 2.

DRA makes several recommendations related to the calculation of working cash, including removal of \$200,000 for minimum bank cash deposit and adjustment of customer deposits from \$1,089,300 to \$1,135,700. DRA also makes several recommendations regarding the calculation of the average deficiency as a result of paying expenses, taxes and accrued depreciation in advance of collecting revenues. Exhibit DRA-1, ch. 10 (Rauschmeier), at 10-3. DRA further recommends several adjustments to the lead-lag study, including: (1) decreasing revenue lag days from 56 to 51; (2) including debt interest expense with the calculation of lag days; (3) removing depreciation expense from the calculation of lag days; (3) adjusting purchased water expense lag days from 4.6 to 40.3; (4) adjusting pump tax expense lag days from 11 to 46.8; (5) adjust rent lead days from 76.1 to 15; and (6) adjust expense lag days for the Other O&M category from 9.8 days to 45 days. *Id.* at 10-4 to 6.

Although not stated in Exhibit SJW-10, SJWC stipulates to the adjustments made to minimum bank cash deposit and customer deposits. SJWC further stipulates to DRA's recommended adjustments (1), (3), (4), (5), and (6) to the lead-lag study. These adjustments are incorporated in the SJWC "SJWC Current" columns in Exhibit JCE-1, Table 2 and Exhibit JCE-2, Table 2.

As noted above, SJWC calculates working cash in conformance with CPUC Standard Practice U-16-W, which specifically states that: "Cash held for construction, for purchases of stock, for payment of dividends, and *interest on funded debt*, and link purposes

*does not qualify for inclusion in working capital.*²⁵ DRA argues that this provision of Standard Practice U-16-W is specific to only debt interest expense as a component of the “cash requirement” of working cash, and that since it is not specifically stated that debt interest expense should not be included in the lead-lag study, this implies that the expense should be included in the lead-lag study. DRA argues that “the lag days related to interest expense must be considered in a lead-lag study, like any other cash expense.” Exhibit DRA-1, ch.10 (Rauschmeier), at 10-4 to 5. However, if this were true, and any “cash expense” should be included in the lead-lag study, then construction cash and dividends, which Standard Practice U-16-W also specifically states should not be included in the “cash requirement”, would be included in the lead-lag study as well. The Commission specifically noted that these expenses, including interest, **should not** be included in the working capital calculation, and thus they should not be included in the lead-lag study. Exhibit SJW-10, ch. 5 (Jensen), at 32-33.

There are many additional indicators within Standard Practice U-16-W that interest expense should not be included in the lead-lag study. In outlining the determination of expense lag days that should be used in a lead-lag study the Commission notes that “the expenses used to develop lag days are separated into their basic components, such as purchased commodities, company labor expensed, types of employee benefits, types of taxes, depreciation, materials, goods and services.”²⁶ Note that neither interest expense, nor a category that interest expense could conceivably be included under, are included in this list. Further, Standard Practice U-16-W provides a sample lead-lag study for a fictitious company California, Light, Power, Gas &

²⁵ CPUC Division of Water & Audits, Standard Practice (“SP”) U-16-W, ¶6, at 1-2. (emphasis added)

²⁶ SP U-16-W, ch. 3, §F, ¶39, p. 1-15.

Water Inc.²⁷ Interest expense *is not included* amongst the revenue and expense items providing in the sample calculation. SJW-10, ch. 5 (Jensen), at 32-33. A review of Standard Practice U-16-W makes it clear that interest expense should not be included in the lead-lag study.

DRA’s recommendation regarding the exclusion of depreciation expense from the lead lag study is also effectively rebutted by Standard Practice U-16-W. In this case, the Standard Practice *specifically lists* depreciation as one of the expenses used to develop lead-lag days.²⁸ Further, Standard Practice U-16-W notes that “Since book depreciation expense is occurring uniformly day by day and accumulated depreciation is deducted from the rate base, the practice is to include depreciation provisions at zero lag days.”²⁹ Finally, depreciation expense is specifically included in the sample lead-lag study for the fictitious California Light, Power, Gas & Water Inc. provided in Standard Practice U-16-W.³⁰

DRA’s predecessor, the Office of Ratepayer Advocates (“ORA”), made a similar argument for the exclusion of depreciation expense in lead-lag study in the Test Year 2006 GRC of Apple Valley Ranchos Water Company. In D.05-12-020, the Commission “decline(d) to make the adjustment in the absences of precedent, or other persuasive arguments by ORA.”³¹ This led to Finding of Fact 12, which states in part: “Depreciation expense is reasonably included in the working cash study as calculated using Standard Practice U-16.”³² Both

²⁷ *Id.*, ch. 3, p. 1-22.

²⁸ *Id.*, p. 1-15.

²⁹ *Id.*, p. 1-15.

³⁰ *Id.*, p. 1-22.

³¹ *Re Apple Valley Ranchos Water Company*, D.05-12-020, at 22.

³² *Id.* at 49.

Standard Practice U-16-W and Commission precedent dictate that depreciation expense should be included in the working cash study.

SJWC notes that the final working capital estimate will be based on what the Commission adopts for operating revenue and for expense items, however the final calculation of working cash *should not* include interest expense and *should* include depreciation expense.

XI.

THE CONSERVATION PROGRAM EXPENSE PROJECTED BY SJWC WILL FUND AN EXPANDED SET OF CONSERVATION PROGRAMS SERVING THE GOALS OF THE WATER ACTION PLAN.

SJWC presented a thorough account of the Company's water conservation programs in Chapter 18 of Exhibit SJW-1, which was sponsored at hearing by Benjamin Pink. SJWC has a long tradition of promoting water conservation and has been an active member of the California Urban Water Conservation Council ("CUWCC") since 2006, with its conservation program closely inked to the Council's Best Management Practices ("BMPs"). Exhibit SJW-1, ch. 18 (Pink), at 1-2.

SJWC's ongoing conservation program consists of a residential and commercial water audit program, distribution of low-flow showerheads and faucet aerators, public information and education, and participation in various programs offered by SCVWD. The latter activities offered by SCVWD, including rebate programs, submetering, landscape surveys, and public outreach, are cost-effective and sensible to offer at a regional level and are indirectly funded through the wholesale rates SJWC pays to SCVWD. *Id.* at 2-9. The total forecasted cost of SJWC's on-going conservation program in 2013 (not including programs indirectly funded through wholesale rates) is \$120,153. Exhibit SJW-2A, ch. 8, WP 8-25.

A further set of water conservation programs is proposed in conjunction with implementation of SJWC's proposed Water Revenue Adjustment Mechanism ("WRAM").

The proposed programs include:

- A landscape budget/survey program to be provided under contract with Waterfluence LLC to improve irrigation efficiency at large urban landscape sites, at a budgeted cost of \$300,000 per year. Exhibit SJW-1, ch. 18 (Pink), at 9-12.
- A high efficiency toilet direct install program, targeted at high density residential housing and available to customers who have received an SJWC water audit that has identified the presence of older, high volume toilets, with an annual budget of \$400,000. *Id.* at 12-14.
- Participation in the existing SCVWD landscape rebate program, duplicating SCVWD's rebate for removal of turf and its replacement with low water use plants, at a budgeted cost of \$340,000 per year. *Id.* at 14-17.
- Cooperation with the firm Resource Action Programs in the provision of "Water Wise" school education kits, a turn-key set of classroom activities and hands-on home projects for young students aimed to increase their water conservation awareness, budgeted at \$100,000 per year. *Id.* at 17-19.
- A commercial, institutional, and industrial ("CII") survey program, with a budget of \$150,000 per year. *Id.* at 19-20.
- A pilot program to study the effectiveness of a new technology – the Aquacue barnacle – to help customers better understand their water use and become more efficient. The Aquacue barnacle is an electronic device that attaches to a water meter and transmits usage data via a cell phone signal. The pilot program is budgeted to cost \$47,000. *Id.* at 21-22.

These new conservation programs would be in addition to the current programs SJWC performs to comply with the CUWCC's BMPs and would be initiated upon implementation of the proposed WRAM in 2013. SJWC's intention is that these new conservation programs only be authorized with concurrent authorization of the proposed WRAM. The total cost for these new programs is projected to be \$4,151,100 over the three-year rate case period, not including the proposed AquaCue pilot program (which would be treated as a capital expense). The cost in Test Year 2013 would be \$1,324,800. Exhibit

SJW-2A, ch. 8, WP 8-25. The programs are shown to be cost-effective. Exhibit SJW-1, ch. 18 (Pink), at 9, 22-24.

Finally, as discussed under the heading of new mains for recycled water in Section IX.E.1, above, SJWC's conservation program budget includes the cost of retrofitting 187 new recycled water customers during the years 2012 to 2014 with purple piping in compliance with DPH requirements. These costs, amounting to \$6,131,200 in Test Year 2013, are included in SJWC's projection of conservation program expense. *Id.*; Exhibit SJW-1, ch. 18 (Pink), at 25.³³ SJWC's combined forecasted conservation expense, including the ongoing conservation, proposed expanded conservation, and recycled water retrofit components, for 2013 is \$7,576,100. Exhibit SJW-2A, ch. 8, at WP 8-25; Exhibit JCE-02, Table 2, p. 3, line 28.

DRA opposes SJWC's proposals to introduce new water conservation programs. DRA notes that customers already have significantly reduced water consumption and this reduction is the primary driver of SJWC's request to increase rates in this GRC. Solely on that basis, DRA would deny authorization for increases conservation spending beyond an extension of the historical trend of this expense. This recommendation, together with DRA's opposition to SJWC's proposed expense for recycled water retrofits, results in an enormous difference in the Conservation Program expense estimates of SJWC and DRA for Test Year 2013, with SJWC estimating that expense (including recycled water retrofits) at \$7,576,000 and DRA estimating just \$78,000. Exhibit DRA-1, ch. 11 (Rauschmeier), at 11-1; Exhibit JCE-2, p. 3, line 28. DRA proposed allowance for Conservation Program expense is a mere 1% of SJWC's request. Tr. 314:28-315:7 (Ma/DRA).

³³ Note that 2013 recycled water retrofit cost of \$5,787,500 in Exhibit SJW-1, ch. 18 (Pink), at 28, is the base-year, non-inflated, estimate and should not be used for forecasting purposes.

DRA criticizes the proposed high efficiency toilet direct install program because it would offer free replacement of toilets that use greater than 1.6 gallons per flush but based its cost/benefit analysis on replacing toilets that use 3.5 gallons or more per flush, calling this an “analytical anomaly.” Exhibit DRA-1, ch. 11 (Rauschmeier), at 11-2 to 3. DRA opposes the proposal to double the rebates for participants in the SCVWD landscape rebate program as costing more than purchased water, SJWC’s most expensive source of water supply. *Id.* at 11-3 to 4. DRA opposes the Waterfluence landscape budget/survey program as duplicating the existing SCVWD program. *Id.* at 11-4. DRA likewise objects to the proposed CII Survey Program and the program to distribute “Water Wise” school education kits as overlapping existing programs. *Id.* at 11-4 to 6. In short, SJWC opposes SJWC’s proposals for “aggressively expanding conservation spending in this rate case and would allow only \$77,800 – less than the current funding for base line conservation programs. *Id.* at 11-8.

SJWC witness Pink responded to DRA’s position by stressing SJWC;s intention to implement the Commission’s own policies favoring water conservation and by correcting errors and misconceptions in DRA’s analysis. Mr. Pink noted that one of the main goals of the Commission’s Water Action Plan is “to strengthen water conservation programs to a level comparable to those of the energy utilities,” and that the requested WRAM-related conservation program would be the first significant increase in SJWC’s conservation programs in many years. Exhibit SJW-10, ch. 11 (Pink), at 11-2. He recognized that water usage was low in 2010 and 2011 due to the economic downturn, cooler weather, and conservation efforts, but noted that water use may rebound and SJWC cannot predict the timing or extent of such a rebound. For this reason, he urged that robust conservation programs must be in place in order to reach the mandated policy goals for 2020 and to comply with public policy goals. *Id.* at 11-2 to 3.

With respect to the proposed high efficiency toilet direct install program, Mr. Pink pointed out that even with conservative assumptions the program has a favorable cost benefit ratio of 2.0 and a discounted cost of water saved that is considerably cheaper than SJWC's cost of purchased water. He also clarified that the program rules dictate that only older toilets of 3.5 gallons per flush or greater would be replaced. In fact, the "analytical anomaly" that DRA saw in prior references to replacing toilets using "greater than 1.6 gallons per flush" is answered by the fact that the older toilets use 3.5 gallons or more and the newer, efficient toilets use no more than 1.6 gallons – there is no product between those two specifications. *Id.* at 11-3.

Responding to DRA's concern that customers have yet to be presented with the positive cost/benefit data on making their own investment in high-efficiency toilets, Mr. Pink noted that the existing SCVWD rebate program has been in place since 2004, with over 10,000 rebates issued. The data that are provided enable customers to make a decision as to whether the program is worth participating in. The program is properly targeted on those customers who still have old, inefficient toilets. *Id.* at 11-3 to 4.

Mr. Pink similarly defended SJWC's calculations of cost-effectiveness and expectations of conservation results for the landscape rebate program, the Waterfluence landscape survey program, the CII water survey program, and the Resource Action school education program. *Id.* at 11-5 to 8. He explained that the correct estimate of Test Year 2013 expense for SJWC's baseline conservation programs is \$104,000 (after correction for double-counting CUWCC dues of \$13,000). *Id.* at 11-8. And he concluded by restating the point that the reduction in per-capita water use in 2011 (to 114 gallons per day does not mean that SJWC has met or will meet the requirement of SBX7-7 that SJWC achieve the target of 111 gallons per day in 2020. Water use may rebound with an improving economy and/or hotter weather and SJWC's conservation programs are consistent with the goals set by the Commission's own

2010 Water Action Plan and cost-effective when compared to the cost of purchasing water from SCVWD. *Id.* at 11-9.

SJWC's new Conservation programs will be cost-effective, but they will not be cheap. They will serve important goals of State policy and the Commission's Water Action Plan. DRA is concerned that vigorous, effective Conservation programs will result in higher rates, but higher rates need not mean higher bills for customers who do conserve, and the long-run effect of the proposed Conservation programs will be to reduce SJWC's need for costly imported water. If the Commission remains committed to its water conservation goals, then it should approve SJWC's Conservation programs along with the WRAM/MCBA, which is essential to eliminate the Company's traditional incentive to promote water sales.

XII.

THE EXPENSES RELATED TO NON-TARIFFED PRODUCTS AND SERVICES THAT DRA SEEKS TO DISALLOW ARE NON-INCREMENTAL AND SO ARE PROPERLY RECOVERABLE IN RATES

SJWC participates in several business activities employing utility assets which would otherwise go underutilized. All risk related to these non-tariffed products and services ("NTP&S") are borne by the shareholders, while the associated revenue generates benefits to both ratepayers and shareholders. The provision of all NTP&S is performed in accordance with the Commission's Rules for Water and Sewer Utilities Regarding Affiliate Transaction and the Use of Regulated Assets for Non-Tariffed Utility Services ("ATRs") established in D.11-10-034. Exhibit SJW-1, ch. 8 (Jensen), at 5.

DRA analyzed SJWC's testimony, supporting work papers, reports, responses to data requests, and information provided in informal channels to establish SJWC's compliance with the Rules. DRA recommends two adjustments related to NTP&S: (1) Classify City of San Jose Miscellaneous contract services as "passive" and apply a 30% revenue allocation to

ratepayers; and (2) Deduct \$285,967 from SJWC labor expense associated with labor utilized for NTP&S provision. Exhibit DRA-1, ch. 12 (Montero), at 5-7.

Although not stated in rebuttal, SJWC concurs with DRA's position regarding the classification of the City of San Jose Miscellaneous contract services. However, DRA's deduction of \$285,967 from SJWC labor expense associated with labor utilized for NTP&S provision is not in compliance with the ATRs authorized in D.11-10-034. Specifically, ATR X.B allows that a utility may offer products and services that (amongst other qualifications) meet the following conditions:

- The NTP&S utilizes a portion of the excess or unused capacity of a utility asset or resource;
- Such asset or resource has been acquired for the purpose of and is necessary and useful in providing tariffed utility services; and
- The involved portion of such asset or resource may only be used to offer the product or service on a non-tariffed basis without adversely affecting the cost, quality or reliability of tariffed utility products and services.

The NTP&S related labor falls under these "excess or unused capacity" qualifications. DRA does not argue this point. Exhibit SJW-10, ch. 5 (Jensen), at 35-36.

This distinction of excess capacity is important because this is in effect an argument of incremental versus non-incremental expenses related to provision of NTP&S. **Incremental** expenses are those that **would not be incurred** by the utility without the provision of NTP&S. DRA recognizes that incremental expenses are not included in SJWC's proposed revenue requirement. The \$285,967 of NTP&S labor expense that SJWC has included in recorded 2011 labor expense is non-incremental. Non-incremental expenses are those that would be incurred by the utility with or without provision of NTP&S. These non-incremental expenses contribute toward the availability of excess capacity. Thus, when DRA concurs that these NTP&S labor expenses are non-incremental, they are in effect agreeing that these expenses contribute toward

excess capacity. The provision of NTP&S does not increase these expenses beyond what is necessary to provide tariffed utility service. Exhibit SJW-10, ch. 5 (Jensen), at 36.

This argument of incremental versus non-incremental expenses affects the expense allocation. Affiliate Transaction Rule X.D. (DRA's basis for excluding the non-incremental NTP&S labor expense) states:

All costs, direct and indirect, including all taxes, incurred due to NTP&S projects shall not be recovered through tariffed rates. These costs shall be tracked in separate accounts and any costs to be allocated between tariffed utility services and NTP&S shall be documented and justified in each utility's rate case. More specifically, all incremental investments, costs, and taxes due to non-tariffed utility products and services shall be absorbed by the utility shareholders, i.e., not recovered through tariffed rates.

The key point is in the last sentence of this rule, wherein the Commission clarified that "More specifically, all incremental investments, costs, and taxes" shall "be absorbed by the utility shareholders, i.e., not recovered through rates." The Commission, by "specifically" pointing out that incremental costs must not be included in rates implicitly determined that non-incremental costs may be recovered through rates. Exhibit SJW-10, ch. 5 (Jensen), at 37.

The \$285,967 labor expense reduction sought by DRA is clearly related to non-incremental NTP&S labor, and thus is allowed for recovery under the Commission's ATRs.

XIII.

SJWC'S PROPOSED 3-TIER RATE DESIGN IS NOT REGRESSIVE AND SHOULD BE APPROVED TO ACCOMPANY A WRAM/MCBA.

SJWC's proposal for residential and non-residential rate design was presented by David Morse, who also was responsible for the Company's revenue decoupling proposal for a full Water Revenue Adjustment Mechanism ("WRAM") combined with a Modified Cost Balancing Account ("MCBA"). SJWC proposes a new residential rate design based on a three-

tiered system intended to encourage water conservation, while proposing to retain the current single quantity rate (“SQR”) for non-residential customers. Exhibit SJW-1, ch. 21 (Morse), at 1.

SJWC’s three-tier residential rate design proposal is conditioned upon concurrent Commission approval of its proposal for a full WRAM/MCBA, presented in Section XIV, below. Absent approval of the WRAM/MCBA, SJWC proposes to retain its present two-tier residential rate design.

SJWC’s current rate design, created in collaboration with DRA, was implemented in November 2008 based on 2006 data. For meters of one inch or less in size, the current rate design applies a break point of 13 ccf, which 2006 data showed to be approximately the midpoint between annual average and winter average usage. Tier rates are based on ratios of the SQR. As of October 2011, the SQR was \$2.5999/ccf and, with tier break ratios of 0.9676 and 1.064 of SQR, the tier rates were \$2.5157 and \$2.7663. For meters of 1.5 inch or greater, the current rate design applies a break point of 26 ccf. The rationale for distinguishing large and small residential was that the residential class included multi-family residences, but since 2006 SJWC has reclassified such customers as business, so the 1.5 inch meter and over class now includes just 0.6% of customers and 2% of residential use. Given the minimal impact, SJWC now proposes a single three tier rate design applicable to the entire residential customer class. *Id.* at 1-2.

Based on a detailed examination of recent consumption data, SJWC’s new three-tier rate design will set the tier 1 rate below the SQR, the tier 2 rate at the SQR, and the tier 3 rate above that level, in order to send an appropriate price signal to encourage water conservation at higher levels of consumption. This rate design increases customers’ financial incentive to conserve water, which promotes objectives of the Commission’s Water Action Plan, and it will

help SJWC meet the state's goal of reducing water consumption by 20% by 2020. Exhibit SJW-1, ch. 21 (Morse), at 2-3.³⁴

The proposed tier 1 break point is set at 9 ccf, a proxy for average indoor usage, while the tier 2 break point is 15 ccf, approximately the annual average usage for SJWC residential customers.³⁵ The indoor water usage proxy is aimed to provide a discount to those customers who conserve and use water saving technology. The new rate design would include about 55% of consumption in tier 1, down from almost 69% with the current two-tier rate design. Setting the tier 2 break point at annual average usage is intended to provide a financial disincentive to consume above that average – including for landscape irrigation during warmer periods. *Id.* at 3-5.

In SJWC's proposed rate design, the tier 1 rate is set at 97% of SQR, close to the same slight discount as in the present tier 1 rate. The tier 2 rate is set at the SQR and the tier 3 rate is 6.5% higher, in order to achieve revenue neutrality. With this rate design, 53% of revenue will be derived from tier 1, 19% from tier 2, and 28% from tier 3. *Id.* at 5-6.

For non-residential customers, SJWC proposes to retain the current SQR design, charging a single volumetric rate for all usage. This is appropriate considering the heterogeneity among customers, which would cause break points between rate tiers to be arbitrary unless based on detailed customer surveys. Since the non-residential class already is

³⁴ The new rate design is intended to encourage water conservation, and thus to reduce sales of water, which will in turn reduce revenue. With implementation of a WRAM/MCBA, any over or under-collection of revenue from the adopted level will be tracked and eventually refunded or surcharged. Accordingly, SJWC conditions its proposal of a three-tier residential rate design on authorization of the WRAM/MCBA as proposed.

³⁵ These criteria are consistent with the approach the Commission has approved for three-tier rate designs for California Water Service Company. *Id.* at 2-3, *citing*, D.08-07-008.

in compliance with CUWCC's definition of "conservation rates," with over 70% of revenue recovered from commodity (usage) rates and since SJWC pursues significant water conservation programs in the non-residential sector, there is no need to impose an arbitrarily differentiated rate design on the non-residential customer class. *Id.* at 8-10.

DRA offers a very different and more drastic approach to rate design. DRA recommends a rate design that avoids any increase in rates to customers with the lowest monthly consumption. To achieve this result, DRA proposes a first-tier breakpoint of 3 ccf/mo, based on a 100 liter-per-day standard. With a second-tier breakpoint of 19 ccf, 20% of residential consumption would be within the first and third tiers, with 60% of consumption charged at the second tier rate. Exhibit DRA-1, ch. 14 (Rauschmeier), at 14-1 to 3. The major effects of DRA's rate design, as compared with SJWC's, would be a significant reduction in charges to low-use customers, especially those using no more than 3 ccf, made up for by slightly higher rates for all usage above 3 ccf. *Id.* at 14-4 (see graph on that page).

DRA cites a 100 liter-per-day standard from a report that notes a range "between 27 and 200 liters per capita per day, bracketing the level of 100 liters per capita per day... as typical household demand in water-scarce nations."³⁶ The same report, on the previous page, also provides a table outlining "Average residential end-use of water in developed countries (liters per person per day)" and shows averages for the United States, California, and Northern California which are 295, 531, and 432 liters per person day respectively.³⁷ Although the 432 liters per day for Northern California is provided in the report cited by DRA, DRA based their

³⁶ Gleick, P., *Basic Water Requirements for Human Activities: Meeting Basic Needs*, International WaterResources Association, 1996, at 87.

³⁷ *Id.* at 86.

rate design on the much lower value of 100 liters per person, a standard for “water scarce nations.” Exhibit SJW-19, at 87.

DRA purports to see a regressive character in SJWC’s rate design proposal, by which the highest-consumption residential users would incur the smallest percentage increase. According to DRA, at SJWC’s proposed rates, low usage customers (using 3 ccf/mo.) would see a 20% bill increase while moderate users (10 ccf/mo.) would see a 19% increase and very heavy users (100 ccf/mo.) would bear only an 18% increase. *Id.* at 14-1 to 2.

In rebuttal testimony, Mr. Morse showed flaws in DRA’s claim that SJWC’s proposed three-tier rate design would have regressive effects. Looking only at the effects of SJWC’s proposed rate design, without considering proposed changes in revenue requirement, Mr. Morse showed that the percentage bill increases resulting from SJWC’s proposed rate design would be relatively constant from low to high consumption, with the highest increase of \$0.31 (1.02%) at the level of 12 ccf – again a moderate, not a small user. *Id.* at 10-19 to 21 (*see especially*, Table 4).

Mr. Morse also urged the Commission to ease the transition from a two-tiered to a three-tiered rate design by selecting the rate design (SJWC’s) that features a higher tier 1 breakpoint and more modest discount rates. *Id.* at 10-14. He contrasted SJWC’s proposed rate design, under which 55% of residential consumption would be in the first tier, with DRA’s proposal, which would have less than 22% of consumption in tier 1. He made the point that SJWC’s three-tier proposal benefits more customers, since more customers would be billed at an average rate below the SQR. He also noted that SJWC’s rate design is more in line with rates the Commission has adopted for other large water companies. *Id.* at 10-15 to 16.

XIV.

A WRAM/MCBA WILL ACHIEVE REVENUE DECOUPLING AND SO ELIMINATE SJWC'S DISINCENTIVE TO PROMOTE WATER CONSERVATION

SJWC proposes to implement a revenue decoupling mechanism similar to the Water Revenue Adjustment Mechanism (“WRAM”) and Modified Cost Balancing Account (“MCBA”) that the Commission has approved for several other Class A water utilities.³⁸ Exhibit SJW-1, ch. 19 (Morse), at 2.

SJWC currently employs a “Monterey-style” WRAM, which essentially is a “pricing” adjustment mechanism that simply tracks the difference between revenue the Company receives through its currently authorized two-tier volumetric residential rates and the revenue it would have received through a uniform single quantity rate (“SQR”).³⁹ This type of WRAM does not decouple sales from revenues, and so does not affect the existing incentive for the utility to promote and increase water sales, which results from traditional water ratemaking procedures that use projections of sales to set rates. These ratemaking procedures are “a major disincentive to promote successful and aggressive water conservation programs.” By approving SJWC’s WRAM/MCBA proposal, in line with the Commission’s energy conservation policy and similar mechanisms that have been approved for several other Class A water utilities, the Commission will provide SJWC a strong incentive implement and pursue

³⁸ WRAM/MCBA mechanisms were adopted for California Water Service Company, and Park Water Company in D.08-02-036, for Golden State Water Company in D.08-08-030, and most recently for Valencia Water Company in D.10-12-029. In each instance, the Commission approved a settlement agreement between the utility and DRA, approving the WRAM/MCBA along with a conservation-oriented rate design.

³⁹ The Commission approved the Monterey-style WRAM, described as a “pricing adjustment mechanism,” along with a conservation-oriented rate design for SJWC pursuant to a settlement agreement between SJWC and DRA, in the same ordering paragraph of D.08-08-030 that approved a WRAM/MCBA for Golden State Water Company. *See*, D.08-08-030, at 24, 41-42 (Ordering Paragraph 1).

more aggressive and cost-effective conservation programs. *Id.* at 3-6; see also, Tr. 383:16-384:12 (Tully/DRA).

The proposed 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 ensure recovery of actual costs for purchased water, pump tax, and purchased power, reflecting variations due to changes in unit cost, amount of consumption, and availability of supplies.⁴⁰ Fixed costs not included in the WRAM are recovered through the monthly meter charge, which does not vary with consumption. The WRAM will track the difference between adopted and actual revenue, excluding Private Fire Protection and other revenue derived other than from metered service (but including revenue from metered recycled water service). Exhibit SJW-1, ch. 19 (Morse), at 8-10. SJWC proposes to apply the amortization, trigger, and reporting procedures recently adopted for other utilities' WRAM/MCBA mechanisms in D.12-04-048, in A.10-09-017.⁴¹

The conservation rate design and more aggressive conservation programs that SJWC has proposed may cause significant variations in the amount of water consumed and in the total cost of water production. The WRAM/MCBA is designed to ensure that SJWC and ratepayers are proportionally affected when conservation rates and programs are implemented. With or without a WRAM, it is critical to forecast sales as accurately as possible. *Id.* at 10-12.

⁴⁰ The MCBA will replace SJWC's current incremental cost supply offset accounts. With adoption of the WRAM/MCBA, those current accounts will be closed, with any balances added to the MCBA.

⁴¹ The amortization procedures and related issues that were addressed in A.10-09-017 and resolved in D.12-04-048 are described in Exhibit SJW-1, ch. 19 (Morse), at 17-19. Since D.12-04-048 was adopted well after the preparation of Exhibit SJW-1, SJWC accepts the resolution of these issues in D.12-04-048 as applicable to its proposed WRAM/MCBA.

DRA does not support approval of a full WRAM/MCBA mechanism for SJWC, recommending instead that SJWC continue with the current Monterey-style WRAM and its current Incremental Cost Balancing Account (“ICBA”). Exhibit DRA-1, ch. 16 (Tully), at 16-1. According to DRA, SJW does not need a WRAM/MCBA to achieve conservation goals, because it already meets or exceeds the State’s water conservation policy goals with a Monterey-style WRAM and an ICBA. *Id.* at 16-6. DRA claims that applying a Monterey-style WRAM to SJWC was justified based on a water supply situation where SJWC was constrained by its reliance on SCVWD for almost half its water, and that the supply situation has not changed. *Id.* at 16-7 to 8.

DRA asserts that SJWC “has already exceeded their 20/20 [water conservation] goals nine years ahead of schedule,” and so would focus on maintaining current conservation objectives “while rewarding ratepayers with affordable water, not charging more in order to drive consumption even lower.” DRA now appears to consider the WRAM to present a risk to affordable rates. *Id.* at 16-9. DRA notes that problems with other utilities’ WRAM/MCBA programs are “just starting to surface and have not been resolved,” citing customer comments at public hearings in a Golden State Water Company rate case and noting the investigation of WRAM-related issues ordered in D.12-04-048. *Id.* at 16-11 to 14.

DRA criticizes the WRAM/MCBA as “too broad,” asserting that the WRAM/MCBA “was never intended to be a broad revenue guarantee for utilities to cushion themselves from the effects of a severe economic downturn and it is questionable that IOUs be given this level of protection from business risk.” DRA also sees a “lack of symmetry” as “what is fundamentally wrong with WRAM/MCBA,” in that 36 of the 37 districts examined in the recent A.10-09-017 have recorded under-collections and only one was over-collected.

Accordingly, DRA recommends that SJWC continue with its current Monterey-style WRAM and ICBA mechanism. Exhibit DRA-1, ch. 16 (Tully), at 16-14 to 16.

SJWC witness Morse responded to DRA's position by emphasizing the linkage between SJWC's request for a full decoupling WRAM/MCBA and its proposal for a three-tier conservation rate design. Without a WRAM/MCBA, SJWC is at risk for reduced sales and is unwilling to move to a three-tier rate design without approval of a WRAM/MCBA. Exhibit SJW-10, ch. 10 (Morse), at 10-2. Mr. Morse notes that DRA's opposition to decoupling for SJWC ignores relevant State and Commission policy considerations and fails to consider the "fundamental truth that without decoupling, SJWC loses (or gains) revenues in conjunction with reduced (or increased) sales." *Id.* at 10-3 to 4.

Moreover, contrary to DRA's claim, SJWC's supply position has in fact significantly changed. Supplies from SCVWD have been reduced due to environmental protection issues concerning the Sacramento Delta, and SJWC's surface water supplies are constrained because the Company's Montevina Water Treatment Plant cannot treat water to design capacity due to water quality issues. These changes justify conversion to a full WRAM/MCBA. *Id.* at 10-5.

DRA witness Tully contended that SJWC has "a natural incentive to conserve," based on its take-or-pay contract with SCVWD and their limited groundwater supplies. Tr. 394:3-18 (Tully/DRA). The only limit he could identify was a limit "based upon the water tables," but he did not know how the theoretical limit on groundwater production was related to the current volume of groundwater SJWC actually produces. In fact, no such constraint exists, and therefore, DRA has been unable to demonstrate any constraint on SJWC's water production or water supply that justifies denying SJWC a WRAM/MCBA. Contrary to DRA's claim, if SJWC's current Monterey-style WRAM remains in place, SJWC will have a "natural incentive" to sell more water.

The public statements about other utilities' WRAM mechanisms, to which DRA refers, do not reflect a correct understanding of how the WRAM functions and mainly concern increases in costs when consumption is reduced. But reduced sales will lead to increased rates with or without a WRAM/MCBA, since more than 50% of fixed costs are recovered through the quantity charges. Exhibit SJW-10, ch. 10 (Morse), at 10-7. DRA witness Tully admitted that the under-collections that are of such concern to DRA were a consequence of inaccurate sales and revenue forecasts, and that if those forecasts had been more accurate, the under-collections would have been less. Tr. 386:7-387:9 (Tully/DRA).

DRA's concern about the WRAM/MCBA lacking "symmetry" also is wide of the mark. As Mr. Morse testified, the under-collections experienced by several water utilities are not due to a lack of symmetry in the WRAM/MCBA, but rather a consequence of actual revenues being less than adopted forecasts. Proper evaluation of the mechanism's symmetry is not achieved by focusing solely on what happens when sales are less than adopted levels. Rather, the test for symmetry is how the mechanism works for sales above and below adopted levels – where impacts in both directions should be "proportional." DRA has provided no evidence that the WRAM/MCBA in use by other Class A water utilities lacks symmetry where that term is properly defined. Indeed, the evidence is to the contrary. Exhibit SJW-10, ch. 10 (Morse), at 10-8 to 9.⁴²

Mr. Morse rebutted DRA's claim that the WRAM/MCBA is "too broad." The issue "is not relevant to the fundamental policy question to decouple or not to decouple. This business risk issue was properly addressed in the cost of capital proceeding." *Id.* at 10-9.

⁴² Mr. Tully admitted, in effect, that the perceived lack of symmetry was a result of over-optimistic revenue forecasts. Tr. 391:12-394:2 (Tully/DRA).

DRA's recommendation to reject the WRAM/MCBA proposal means that San Jose would continue with its ICBA rather than the MCBA, to the detriment both of ratepayers and SJWC. Mr. Morse points out that the ICBA only tracks the incremental changes in the prices; it does not track changes in usage over GRC-adopted levels. "With an ICBA, if SJWC reduces sales over the adopted level, ratepayers in effect over compensate SJWC for purchased water and purchased electricity." *Id.* at 10-12. With an MCBA actual purchases and prices are tracked and the Commission's goal of "symmetry" is achieved.

There is no reason to require SJWC to remain subject to a Monterey-style WRAM and an ICBA just because that is the status quo. As noted above (see notes 38 and 39) both the other utilities' WRAM/MCBAs and SJWC's Monterey-style WRAM are the results of non-precedential settlement agreements accepted by the Commission. See also, Tr.380:28-383:15 (Tully/DRA). Absent any significant difference in SJWC's circumstances, there is no good reason for not approving the same revenue decoupling mechanisms for SJWC as have been implemented by most of the other Class A water companies.

Contrary to DRA's change of tune about the WRAM/MCBA, the Commission has not abandoned the WRAM/MCBA and the recent D.12-04-048 gives no indication that the Commission intends to do so. As Mr. Morse testified, that decision concluded that a key reason for the large under-collections has had nothing to do with the WRAM/MCBA but rather with the adopted sales forecasts. The decision calls for a "vigorous review of the WRAM/MCBA mechanism" in each applicant's next GRC, so it is entirely appropriate for the Commission to address decoupling issues in this SJWC proceeding and to implement an appropriate mechanism that gives SJWC the same set of incentives that are at work for other Class A water companies to promote the State's and the Commission's goal of water conservation. Exhibit SJW-10, ch. 10 (Morse), at 10-10 to 11.

XV.

BALANCING AND MEMORANDUM ACCOUNTS

A. A Health Care Memorandum Account Is Appropriate in View of Current
Uncertainty About Future Health Care Costs

SJWC has experienced dramatic year-to-year fluctuations in medical and dental premiums. These fluctuations will likely be amplified by the recent passing of the Patient Protection and Affordable Care Act (“ACA”). Further, it is anticipated that in future years the IRS may determine that these benefits are taxable, thus increasing employer and employee payroll tax liabilities. Therefore, SJWC requests the Commission authorize a Health Care Cost Memorandum account effective January 1st, 2013 to allow for the recovery of the unpredictability of premium increases, for both medical and dental, and the account uncertainty of the impacts of the ACA. Exhibit SJW-1, ch. 5, at 8-10.

DRA argues that increasing health care costs are adequately addressed in SJWC’s forecasting methodology (escalating last recorded year) and indicates that cost fluctuations can be addressed by increasing the employee contribution. Exhibit DRA-1, ch. 15, at 3-4. But DRA witness Rauschmeier acknowledged the uncertainty about new health care costs that may result from the ACA and from related court decisions. Tr. 233:8-19 (Rauschmeier/DRA).

SJWC has limited flexibility to increase employee contribution in the short term. In future union contract negotiations SJWC may seek greater cost sharing. However, in 2010, the Company negotiated a three year contract (effective through December 31, 2013) with two unions representing more than 70% of the total number of employees and is unable to re-negotiate the employee cost-sharing until the next contract period. Exhibit SJW-10, ch. 8 (Leal), at 22.

The ACA presents unknown costs that should be considered “extraordinary” due to the unidentifiable impact that it will have on employers in the future. This is of an exceptional nature and is beyond SJWC’s control. Health care providers will likely increase and pass through the cost of the administrative burdens placed on them by the ACA. Employers are extremely concerned with the cost of the ACA once it is fully implemented and some are considering dropping health insurance altogether and paying the mandated penalty. Currently, ACA related expenses cannot be reasonably forecasted and will occur before the next scheduled rate case. These expenses are likely to be significant. Thus, a Health Care Memorandum Account is justified and should be approved by the Commission. Exhibit SJW-10, ch. 8 (Leal), at 22.

B. An International Financial Reporting Standards Memorandum Account Will Address the Uncertain Impact of a New System of Accounting Standards.

In November 2008, the Securities and Exchange Commission (“SEC”) issued a proposed "Roadmap" for a possible path to the adoption of International Financial Reporting Standards (“IFRS”) in the US. In February 2010, the SEC published a statement of continued support for a single set of high-quality global accounting standards and acknowledged that IFRS is best positioned to serve in that role. As a publicly traded investor owned utility SJW Corp., SJWC’s parent company, will have to comply with the proposed change from reporting its financial results under United States Generally Accepted Accounting Principles (“GAAP”) to reporting under IFRS once the SEC elects to move forward with the initiative. The implementation of IFRS is beyond the control of SJWC and related costs may be significant. Due to the uncertainty related to adoption and the implementation timeline, and due to the magnitude of potential costs related to IFRS conversion and adoption, SJWC seeks authority to establish a memorandum account to prospectively record IFRS compliance related costs due to

the uncertainty surrounding implementation of the standards and the potential significant costs of adoption. Exhibit SJW-1, ch. 17 (Jensen), at 2-3.

DRA argues that an IFRS Memorandum Account is not necessary given the continual process by which utilities must comply with new and regularly updated accounting standards. Further, DRA argues that the standard methodology of averaging past expenses to estimate future expenses captures the cycle of cost increases to comply with new standards, followed by cost decreases through efficiency gains. Thus, DRA recommends the Commission reject the requested IFRS Memorandum Account. Exhibit SJW-10, ch. 15, at 4.

New and regularly updated accounting standards are adopted within the context of an on-going accounting framework; in this case, U.S. GAAP. The adoption of such standards results in incremental changes that are generally focused on a single area of accounting, such as revenue recognition. As such, while a new standard may necessitate changes in financial reporting and IT systems, and incremental staff training, the time and cost associated with the change is not new and is, as DRA has asserted, captured in existing forecasting methodology. However, the adoption of IFRS is a change to a new accounting framework. The change is comprehensive and will impact all areas of financial accounting, reporting, and disclosure. Areas supporting financial accounting and reporting, such as IT, will require major modifications; staff will need to be trained on the new framework and its application to their respective functional areas; significant effort will be required to restate and have audited historical financial information under the new framework; and reporting to third parties such as the CPUC, the IRS and note holders will need to be evaluated and conformed to the new framework, or else dual accounting systems will need to be maintained – one under U.S. GAAP and one under IFRS. The changes required to adopt the new IFRS framework will be

significantly greater than adopting new accounting standards under the existing U.S. GAAP framework. Exhibit SJW-10, ch. 9 (Lynch), at 9-10.

The expenses associated with adopting this new framework will not be adequately captured by using an average of past expenses. This methodology is effective when expenses remain relatively flat on a period over period basis. As previously discussed, however, the cost and effort involved in converting from U.S. GAAP to IFRS will be significant, and therefore recovery of such expenses through balance averaging over an extended period will result in significant expenses that will not be fully recovered. The conversion will include, but not be limited to, evaluating IFRS as it relates to a regulated utility,⁴³ evaluating the impact of IFRS on third party reporting (CPUC, IRS, bond and note holders), extensive staff training, system conversions, new internal control implementation and testing, accounting firm implementation reviews and audit fees associated with required restatements, and potentially running two accounting and reporting systems. As stated in DRA's testimony, the Sarbanes-Oxley law ("SOX") doubled audit fees on average in the year of implementation. Audit fees did not capture the extensive staff and outside service provider fees to test internal controls over financial reporting ("ICOFR") and remediate control deficiencies in advance of audit procedures. Adoption of IFRS is a more comprehensive implementation than SOX, which focused only on ICOFR. There can be no way to accurately predict the cost associated with IFRS in this general rate case or the timing of when adoption will be required by the SEC. Exhibit SJW-10, ch. 9 (Lynch), at 10-11.

⁴³ DRA's witness acknowledged that IFRS has yet to be aligned with U.S. GAAP in the recognition of regulatory assets and regulatory liabilities, a complex and important area of regulatory accounting. Tr. 235:9-27 (Rauschmeier/DRA).

C. A Chromium VI Memorandum Account Is Justified in View of the Enormous Range of Costs That a Chromium VI Contamination Standard Could Entail.

State and Federal efforts are ongoing to set an Maximum Contaminant Level “MCL” for chromium VI. The State appears to be on a faster track, with OEHHA recently having adopted a final Public Health Goal, the first step in CDPH being able to proceed with developing an MCL. Chromium VI naturally occurs in the San Jose area drinking water aquifer materials and is present at very low levels in the water. The full extent of the natural occurrence is not well characterized because no approved method is available yet for low-level chromium VI analysis. The potential cost impact of a very low MCL for chromium VI – even one significantly higher than the recently adopted Public Health Goal – is tremendous. SJWC requests authority to establish a Chromium VI Memorandum Account for potential compliance costs related to the treatment of chromium VI upon the establishment of state and/or federal regulations for treatment levels. The trigger event for establishing this memorandum account will be the establishment of a MCL by the state and/or federal regulatory agencies. This memorandum account will track operating expenses and capital expenditures related to meeting the established MCL. Exhibit SJW-1, ch. 16 (Rodigari), at 5.

DRA argues that the potential promulgation of an MCL for chromium VI would be no different than previous amendments to the Safe Drinking Water Act and that the averaging of recorded expenses with appropriate escalation to arrive at test year forecasts will capture the continuing cycle of cost increases to meet new requirements and cost decreases from efficiency gains. Thus, the costs related to meeting a chromium VI MCL would be captured in forecasted expenses and a memorandum account is not necessary. Exhibit DRA-1, ch. 15 (Rauschmeier), at 6-8.

Unlike previous amendments to the Safe Drinking Water Act, a low MCL for chromium VI has the potential for temporarily or permanently eliminating well water as a source of supply for SJWC. Well water accounts for approximately 40% of SJWC's current production. Existing data for the SJWC wells, albeit incomplete, indicate that all SJWC wells have potential concentrations of hexavalent chromium. Compliance with a future MCL could require treatment at many or all of the Company's wells. OEHA has established a PHG for hexavalent chromium of 0.02 µg/L. As required by law, DPH is to establish an MCL at a level as close as is technically and economically feasible to the contaminant's PHG. DPH has not released a timeline for establishing an MCL but once the MCL is promulgated, public water supplier may be required to comply with an MCL in as little as a year. Exhibit SJW-10, ch. 13 (Rodigari), at 5-6.

It is highly likely that the promulgation and compliance timeline for a hexavalent chromium MCL will not be congruent with a GRC cycle. SJWC's request for the creation of a memorandum account for hexavalent chromium meets all four criteria established by the Commission. The regulation of chromium VI is exceptional in nature in that the DPH would be promulgating an MCL before the US EPA promulgates its own MCL, is not under SJWC's control, could not be reasonably foreseen in this GRC, may occur before the next GRC, and is potentially substantial in its financial impact.⁴⁴ Ratepayers will benefit by SJWC treating this potential expense with a memorandum account because they will be charged accurately for the expense of compliance with an MCL for chromium VI. Exhibit SJW-10, ch. 13 (Rodigari), at 5-6.

⁴⁴ The scale of potential costs of compliance with a Hexavalent Chromium standard is illustrated by Exhibit SJW-12 (Rodigari). *See*, Tr. 140:22-143:22; 144:13-28 (Rodigari/SJWC).

D. It is Premature to Amortize Resolution L-411 Memorandum Account

On December 17, 2010, President Obama signed the Tax Relief Act. Among other provisions, the Tax Relief Act provides for 100% bonus depreciation on certain business property put into service after September 8, 2010 and before January 1, 2012, and 50% bonus depreciation for property placed into service thereafter and before January 1, 2013. On June 23, 2011 the Commission passed Resolution L-411A. This Resolution established a one-way memorandum account for all cost-of-service rate regulated utilities that do not address the Tax Relief Act in a 2011 or 2012 test year GRC to track the impacts of the new Act. SJWC filed advice letter 432A on August 18, 2011 to open a 2010 Tax Act Memorandum Account in compliance with this Resolution. This filing was approved by the Commission in August of 2011. Exhibit SJW-1, ch. 10, at 3.

DRA argues that the accumulated excess earnings in the account at the end of 2011 should be amortized and refunded to ratepayers. DRA further suggests that the excess earnings balance at the end of 2012 should be refunded through an advice letter when the final amount for 2012 is known. Exhibit DRA-1, ch. 17 (Rauschmeier), at 4.

In rebuttal testimony, SJWC noted that DRA's claimed memo account balance of \$452,200 was based on preliminarily estimated entries for debits, credits, and balances in the memorandum account through the end of 2011 and was not based on actual entries. In fact, actual entries cannot be finalized until the tax returns are filed for the respective periods following the memo account effective date of April 14, 2011. For example, the actual amounts for the entries in 2011 cannot be determined until SJWC files the 2011 tax return. The fact that this account "balance" was completely based on preliminary estimates was pointed out to DRA during the discovery process. Exhibit SJW-10, ch. 5, at 39-40.

SJWC should not be required to refund an over-collection that is based on preliminarily estimated debit and credit entries. DRA concurs with this assessment, noting that regarding the stated memorandum account balance: “Unfortunately, DRA’s calculation of that amount based on responses it received from San Jose Water Company was placed into an estimate in a memorandum account. And that is an improper procedural vehicle, as memorandum accounts are only meant to record actual expenses.” Tr. 341:3-9 (Rauschmeier/DRA). It is SJWC’s understanding that DRA has stipulated to the removal of this balance from the total memorandum account balance, as indicated in Exhibit JCE-01, Table 4, line 9.

SJWC recommends that the memo account be reviewed in the next General Rate Case in 2015, unless any balance exceeds 2% of authorized revenue requirement. Exhibit SJW-10, ch. 5, at 41.

E. The Commission Should Authorize Recovery of Balancing and Memorandum Account Balances as Stated in SJWC’s Rebuttal Testimony.

SJWC requested the disbursement of an under-collection of \$2,598,912 accrued in balancing accounts via a 12-month surcharge of \$0.0492 per ccf and the recovery of \$650,456 accrued in various memorandum accounts via a 12-month surcredit of \$0.2498 per service connection per month. Exhibit SJW-1, ch. 17 (Jensen), at 3.

DRA agreed with SJWC’s requested balancing account amortization, but originally recommended amortization of a memorandum account balance over-collection of \$1,102,656 via a 12-month surcredit of \$0.4216 per service. *Id.* at 4. As noted above, DRA subsequently removed the over-collection associated with the Resolution L-411A Memorandum Account, and agreed to the memorandum account over-collection stated in SJWC’s Application.

In rebuttal testimony SJWC noted that in the original Application the Water Quality Memorandum Account balance of \$9,623 was erroneously entered as an over-collection. Exhibit SJW-2A, ch. 17, at WP 17-2. In actuality, this balance should have been included as an over-collection. Correcting for this error has the effect of reducing the total stated over-collection by \$19,246, or two times the Water Quality Memo Account balance of \$9,623 to account first for the presumptive “over-collection” and to account for the actual under-collection. This has the effect of reducing the proposed surcredit to \$0.2415 per service connection per month. Exhibit SJW-10, ch. 5 (Jensen), at 27-38.

XVI.

CONCLUSION

For all the reasons exhaustively stated in the foregoing pages, San Jose Water Company respectfully asks that the Commission authorize increases in rates for Test Year 2013 and Escalation Years 2014 and 2015 sufficient to enable the Company to meet and carry out the many and varied challenges and obligations discussed herein.

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