
PUBLIC UTILITIES COMMISSION505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

July 19, 2004

Agenda ID #3734
Ratesetting

TO: PARTIES OF RECORD IN APPLICATION 03-05-035

This is the proposed decision of Administrative Law Judge (ALJ) Fukutome, previously designated as the principal hearing officer in this proceeding. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. This matter was categorized as ratesetting and is subject to Pub. Util. Code § 1701.3(c). Pursuant to Resolution ALJ-180 a Ratesetting Deliberative Meeting to consider this matter may be held upon the request of any Commissioner. If that occurs, the Commission will prepare and mail an agenda for the Ratesetting Deliberative Meeting 10 days before hand, and will advise the parties of this fact, and of the related ex parte communications prohibition period.

The Commission may act at the regular meeting, or it may postpone action until later. If action is postponed, the Commission will announce whether and when there will be a further prohibition on communications.

When the Commission acts on the proposed decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the proposed decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at <http://www.cpuc.ca.gov>. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ ANGELA K. MINKIN
Angela K. Minkin, Chief
Administrative Law Judge

ANG:hl2

Decision **PROPOSED DECISION OF ALJ FUKUTOMI (Mailed 7/19/2004)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SAN JOSE WATER COMPANY (U 168 W) for an Order authorizing it to increase rates charged for water service by \$25,793,000 or 18.20% in 2004; by \$5,434,000 or 3.24% in 2005; and by \$5,210,000 or 3.01% in 2006.

Application 03-05-035
(Filed May 23, 2003)

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**OPINION ON SAN JOSE WATER COMPANY'S
GENERAL RATE CASE REQUEST FOR TEST YEARS 2004 AND 2005**

TABLE OF CONTENTS

Title	Page
OPINION ON SAN JOSE WATER COMPANY’S GENERAL RATE CASE REQUEST FOR TEST YEARS 2004 AND 2005	2
1. Summary	2
2. Procedural History.....	2
3. SJWC’s Request	4
4. ORA’s Recommendation.....	5
5. VTA’s Request	6
6. Settlement.....	6
a. Customers and Consumption.....	7
b. Operation and Maintenance Expenses.....	7
1. Escalation.....	7
2. Operations – Source of Supply.....	8
3. Operation – Pumping.....	8
4. Operation – Water Treatment	8
5. Operation – Customer Accounts	9
6. Maintenance – Pumping	9
7. Maintenance – Transmission and Distribution	9
8. Other	10
c. Administrative and General Expenses.....	10
d. Balancing and Memorandum Accounts	11
e. Plant.....	11
f. Depreciation	13
g. Rate Base	13
h. Rate of Return	13
i. Attrition.....	14
j. Design of Rates.....	14
1. Rate Assistance for Low-Income Customers	14
2. Resale Service	15
3. Private Fire Service	15
4. Residential Fire Sprinkler Service.....	15

TABLE OF CONTENTS
(Continued)

Title	Page
7. Water Main Relocation Costs	15
a. Background.....	16
b. Discussion – Ratemaking Considerations.....	19
c. Discussion – Ratepayer Benefits.....	21
8. Comments on Proposed Decision.....	23
9. Assignment of Proceedings	24

Appendices:

Appendix A	Settlement
Appendix B	San Jose Water Company Adopted Rates
Appendix C	San Jose Water Company Adopted Summary of Earnings
Appendix D	San Jose Water Company Adopted Quantities
Appendix E	San Jose Water Company Residential and Business Bill Comparison for Present and Proposed Rates
Appendix F	San Jose Water Company Requested Recovery From Water Contamination Litigation Memorandum Account
Appendix G	San Jose Water Company Surcharge Information

**OPINION ON SAN JOSE WATER COMPANY'S
GENERAL RATE CASE REQUEST FOR TEST YEARS 2004 AND 2005**

1. Summary

This decision adopts the settlement between San Jose Water Company (SJWC) and the Office of Ratepayer Advocates (ORA) and grants SJWC authority to increase rates by \$11,773,000, or 8.00% for test year 2004; by \$4,283,000, or 2.69% for test year 2005; and by \$4,245,000, or 2.59% for attrition year 2006. The decision does not adopt additional ratepayer funding of water main relocation projects as requested by the Santa Clara Valley Transportation Authority (VTA).

2. Procedural History

SJWC filed this general rate case (GRC) application pursuant to Pub. Util. Code § 454,¹ which governs proposed rate changes. On July 1, 2003, ORA filed a protest to the application. Also, on June 30, 2003, the assigned Administrative Law Judge (ALJ) received a telephone call from VTA's attorney who indicated that VTA would be participating on an issue related to the cost of relocating water mains. A Prehearing Conference (PHC) was held on August 22, 2003. Among other things, the protest, scope of the proceeding, procedural schedule and SJWC's request for interim rates were discussed. Appearances were taken for representatives of SJWC, ORA and VTA.

The Assigned Commissioner's Scoping Memo and Ruling was issued on September 12, 2003. That ruling set forth the scope, schedule, category, assignment of the principal hearing officer and ex parte communications rules

¹ Unless indicated otherwise, all statutory citations are to the Public Utilities Code.

for this proceeding, pursuant to Rule 6.3 of the Commission's Rules of Practice and Procedure (Rules).

On September 26, 2003, VTA filed a preliminary brief and report to clarify the substance of, and the authority for, its request to have ratepayers fund certain pipeline relocation project costs incurred by VTA in the construction of its light rail transit system. Responses were filed by SJWC and ORA on October 3, 2003.

On October 9, 2003, an ALJ ruling granted the request of the County of Santa Clara to intervene as an interested party.

In lieu of public participation hearings, a notice requesting public comment was sent to all SJWC customers, either through a bill insert or special mailing.² The proposed increase, the effect on customers and the Commission process for implementing rate changes were described in the notice. Input on any aspect of the company's operations, proposed rate increases, quality of service or other concerns was solicited. Approximately 130 letters or e-mails were received by the Commission's Public Advisor's Office and distributed to the Commissioners, the assigned ALJ, ORA and other Commission staff.

Topics addressed in the customers' comments include the large size of the proposed increases when compared to inflation, the frequency of rate increases, the effect of high rates on the quality of life, the apparent anti-conservation rate design (the percent increase is reduced when more water is consumed), the poor quality of the water, support for gray water systems, lower rates in neighboring

² Special mailings were required in cases where a bill insert would not reach customers by October 26, 2003. The intent was to allow customers time to respond and ORA time to incorporate any related recommendations in its testimony that was due to be mailed on November 17, 2003.

communities, and insistence that SJWC should make visible and substantial sacrifices to share in the burden of harsh economic times.

On November 17, 2003, ORA and VTA issued testimony addressing SJWC's request. On December 8, 2003, SJWC issued its rebuttal testimony.

On December 4, 2003, the Commission issued Decision 03-12-007, which granted SJWC interim rates, effective January 1, 2004, pursuant to the provisions of § 455.2.

On December 29, 2003, ORA filed a motion to dismiss VTA's request. As discussed later in this decision, a January 29, 2004 ALJ ruling denied ORA's motion, in part.

On January 26, 2004, SJWC and ORA filed a joint motion to adopt a settlement. The settlement reconciled all issues between the two parties. On February 3, 2004, an evidentiary hearing was held to address the settlement document. On March 8, 2004, revised pages to the settlement were submitted.

On February 25, 2004 evidentiary hearing on VTA's request was held. Opening briefs on this issue were filed on March 30, 2004. Reply briefs were filed on April 6, 2004, at which time this matter was submitted for decision.

3. SJWC's Request

In its application, SJWC requested that its authorized revenues for water service be increased by \$25,793,000, or 18.20%, for 2004; \$5,434,000, or 3.24%, for 2005 and \$5,210,000, or 3.01%, for 2006. SJWC also requested authority to (a) recover \$70,606 in its water contamination litigation memorandum account, (b) recover a \$382,068 under-collection in its balancing account, (c) establish a lifeline rate, (d) record certain costs in a water quality memorandum account, (e) eliminate the fire hydrant maintenance balancing account, (f) convert to straight line depreciation, and (g) convert to a full cost supply balancing account.

SJWC also requested a finding that it is in compliance with all pertinent state and federal water quality standards.

On June 20, 2003, SJWC submitted an update of its application, as permitted by the Rate Case Plan, to reflect an offset rate increase effective July 1, 2003, the Santa Clara Valley Water District proposed water and pump tax rates for 2004, 2005 and 2006, and the current accrual for unfunded pensions. Based on the update, SJWC's requested increases amounted to \$23,042,000, or 15.65%, in 2004; \$10,039,000, or 5.88% in 2005; and \$9,790,000, or 5.42% in 2006.

4. ORA's Recommendation

In its direct testimony, ORA recommended that SJWC's rates be increased by 3.37%, for test year 2004, 1.55%, for test year 2005 and 0.89%, for attrition year 2006. As part of its recommendation, ORA deferred recovery of a number of capital projects to future advice letters, which would be filed after the projects were completed. In addition, ORA recommended that the Commission adopt a 15% discount for qualifying low-income customers and modify the rate design for resale, private fire and residential fire sprinkler services. ORA agreed with SJWC's requests related to recovery of an updated balance of \$78,629 in the water contamination litigation account and an updated under-collection of \$379,960 in the balancing account. ORA also agreed with the elimination of the fire hydrant balancing account. ORA disagreed with SJWC's request to change to a full cost balancing account and the establishment of a water quality memorandum account. ORA also disagreed with SJWC's request to convert to the use of a computerized straight-line method of calculating depreciation, recommending that any change to the Commission's Standard Practice U-4 for calculating straight-line remaining life depreciation should be done through workshops conducted with interested Commission staff and members of the water industry.

5. VTA's Request

VTA requests that ratepayers should fund 37.4% of \$14.6 million, or \$5.5 million, in water main relocation costs associated with its light rail transit line construction; that amount would be reimbursed to VTA by SJWC. VTA recommends that the costs should be recovered from ratepayers through increased rates determined by the addition of \$5.5 million to the rate base adopted by this decision.

6. Settlement

The "Joint Settlement of the Office of Ratepayer Advocates and San Jose Water Company" (Settlement) is attached as Appendix A to this decision. The Settlement addresses all issues in dispute between SJWC and ORA. In accordance with the terms of the Settlement, SJWC rates charged for water service will be increased so as to increase revenues by \$11,773,000, or 8.00%, in 2004; \$4,283,000, or 2.69%, in 2005; and \$4,245,000, or 2.59%, in 2006. The positions of SJWC and ORA prior to and after settlement are summarized below and are detailed in the Settlement's reconciliation tables.

	SJWC	Settlement Position	ORA
2004 Revenues At Present Rates	\$ 147,231,000	\$ 147,231,000	\$147,231,000
Proposed 2004 Revenues	\$ 170,273,200	\$ 159,004,200	\$152,198,300
Proposed 2005 Revenues	\$ 180,631,200	\$ 163,608,200	\$154,958,300
2006 Attrition Increase	\$ 5,210,000	\$ 4,245,000	\$1,382,200

The Settlement reflects a substantial reduction from SJWC's pre-settlement request. It is also closer to the pre-settlement position of ORA. As discussed

below, based on the direct testimonies of SJWC and ORA and the rebuttal testimony of SJWC, we find the outcomes and terms of the various Settlement elements to be reasonable. The Settlement is also consistent with applicable law and in the public interest, and will be adopted by this decision.

a. Customers and Consumption

The only pre-settlement issue related to customers and consumption is unaccounted-for water. SJWC's estimate of 7.2% was based on a five-year average (1998 – 2002), while ORA's estimate of 6.5% was based on a three-year (2000 – 2002) average to better reflect recent leak detection improvements. The Settlement position of 6.8%, based on the most recent three-year (2001 – 2003) average is reasonable.

b. Operation and Maintenance Expenses

1. Escalation

Based on the December 18, 2003 and January 1, 2004 ratified union contracts and the assertion that non-union labor escalation mirrors that of the unions, the Settlement agrees to use labor escalation rates of 4% for 2004 and 3.5% for 2005 for all payroll costs except that related to SJWC's ten executive salaries. For ratemaking purposes, the ten executive salaries will be maintained at the 2003 level for 2004 and 2005, as recommended by ORA. This agreement is reasonable.

For historic labor escalation and historic and forecasted non-labor escalation, the Settlement's use of ORA's recommended values, which are based on September 2003 economic data as opposed to SJWC's use of May 2003 data, is also reasonable.

2. Operations – Source of Supply

The settlement incorporates ORA's methodologies for estimating purchased water and pump taxes. The use of current purchased water and pump tax rates, rather than estimated test year rates, is reasonable and consistent with current Commission procedures whereby SJWC will be able to file rate offset advice letters for purchased power and pump tax rate increases.

The Settlement incorporates ORA's use of a six-year averaging methodology for transportation and other categories. Except where noted below, the consistent use of the six-year average was employed by the Settlement for operation and maintenance (O&M) and administrative and general expenses, and results in reasonable test year estimates.

3. Operation – Pumping

The Settlement reasonably includes estimates of purchased power, which are based on the Settlement quantities of water pumped in 2004 and 2005.

The Settlement position to adjust purchased services to reflect the allocation of additional security costs and postal software licensing costs is reasonable. SJWC and ORA agree that the programs are necessary and, due to recent implementation, are not reflected in the historic averages used for the test year estimates. The same adjustment is also appropriately reflected in the allocated purchased service costs for source of supply maintenance, pumping maintenance, transmission and distribution O&M expenses and customer accounts expenses.

4. Operation – Water Treatment

The Settlement's use of ORA's estimates for chemicals is reasonable, since ORA's calculation is based on a more recent review of 2003 actual usage and actual chemical unit cost.

5. Operation – Customer Accounts

For the uncollectible rate, ORA's estimate of 0.1652% is based on a six-year (1997 – 2002) average, while SJWC used the 2002 recorded rate of 0.2846 as its estimate. The Settlement agreement to use of a three-year (2001 – 2003) average to estimate an uncollectible rate of 0.1770 is reasonable, in that it incorporates the use of a number of historic rates to account for fluctuations while still reflecting recent economic conditions.

The Settlement's use of current postage rates, as recommended by ORA, is reasonable for calculating postage expense, since postal rates are not expected to increase in the near future.

The Settlement's use of ORA's estimate of conservation costs is reasonable. In addition to the six-year average amount, an additional cost for revising the water management plan is amortized over five years, the interval between plan revisions.

The Settlement's use of ORA's \$0 estimate for the other category of customer accounts expenses is also reasonable, since the minimal historic data is distorted by prior year accounting adjustments.

6. Maintenance – Pumping

The Settlement reasonably includes an additional \$120,000 for each of the test years to fund the rehabilitative maintenance of two wells per year. These expenses to restore lost capacity and extend well life are incremental to historically averaged amounts, since the program is new.

7. Maintenance – Transmission and Distribution

The Settlement includes an additional \$318,000 in 2004 and \$324,678 in 2005 to fund the maintenance of 11,721 fire hydrants that until January 1, 2003, were the responsibility of the City of San Jose. Increased rates related to the

transfer of responsibility to SJWC were previously authorized in Resolution W-4374, dated February 27, 2003. For test year estimating purposes, these expenses are incremental to historically averaged amounts and are reasonable.

8. Other

The agreement that SJWC should be allowed to recover \$145,997 in 2004 and \$262,168 in 2005 in operating costs associated with security enhancements identified and recommended in SJWC's security vulnerability assessment (VA) is reasonable. The VA was required pursuant to the Public Health Security and Bioterrorism Preparedness and Response Act (HR 3448), and it has been certified by the United States Environmental Protection Agency.

The agreement that SJWC should be allowed to recover \$17,458 in 2004 and \$17,825 in 2005 for postal verification software licensing, maintenance and subscription fee is reasonable. The resultant presorting allows SJWC to mail customer statements at a rate of \$0.278, instead of the standard first class postage rate of \$0.37.

c. Administrative and General Expenses

For estimating test year property insurance expense, the Settlement's use of ORA's methodology, which trends recorded data for the period 1997 – 2003, is reasonable.

Based on a review of additional invoices for 2003 as well as review of estimates provided by SJWC's insurance broker, the Settlement estimates for workers' compensation insurance (WCI), public liability insurance (PLI) and directors and officers insurance (DOI) are reasonable. In aggregate, the Settlement amounts of \$2,690,600 for 2004 and \$3,552,887 for 2005 are much closer to SJWC's respective estimates of \$2,714,300 and \$3,588,200 than to ORA's

respective estimates of \$1,817,000 and \$1,994,000. However, the recorded 2003 WCI premium and 8/1/03 to 8/1/04 premiums for PLI and DOI amount to \$2,445,597, which supports the reasonableness of the Settlement amount for 2004. The substantial increase from the recorded 2002 level of \$1,354,600 also supports the significant estimated increase in premiums for 2005.

For regulatory expense, the Settlement's use of ORA's recommended \$50,000 per year, without adjustment for inflation, is reasonable.

The Settlement includes an additional \$141,000 for 2004 and \$143,000 for 2005 for expenses related to compliance with the Sarbanes-Oxley Act of 2002, which requires the establishment and certification of internal financial controls and imposes increased audit fees. Since the requirements are new, the associated costs are incremental to historically averaged amounts and are reasonable.

The Settlement's use of ORA's estimate for rents, which is based on the recent recorded 2002 amounts, escalated to test year dollars, is also reasonable.

d. Balancing and Memorandum Accounts

As part of the Settlement, SJWC withdraws its request for (1) a full cost balancing account for water production expenses and (2) a water quality memorandum account for anticipated future water quality expenses. ORA opposed the establishment of both accounts and the exclusion for consideration in this proceeding is reasonable.

e. Plant

The Settlement's use of beginning of year plant balances for 2004 is reasonable, since this information provides a more recent and reliable starting point for determining test year plant balances, when compared to the beginning of year 2003 balance used by SJWC.

The Settlement resolves the status of 14 specific plant projects. For two of the projects involving approximately \$4 million, ORA and SJWC agree that the projects are prudent, necessary and in the public interest but have removed the costs from the GRC, because SJWC has sought Safe Drinking Water State Revolving Fund (SRF) loans to finance the projects. The parties agree that if the SRF loans are denied, SJWC should be allowed to recover the costs through an advice letter filing. This agreement is reasonable.

For six other projects totaling approximately \$12 million, SJWC and ORA agree that the projects are prudent, necessary and in the public interest, but due to the uncertain timing of the projects, the parties agree to remove the costs at this time and subject the projects to advice letter filings when the projects are actually completed. Use of capital project advice letters is reasonable for these six projects. They are relatively large, non-recurring projects where the timing is uncertain, but where the need, scope and costs have been defined. We will allow SJWC to begin rate recovery for each of the projects, if and when they are completed, by filing an advice letter as proposed. SJWC will combine its requests for recovery to file once in 2004, once in 2005 and once in 2006, to minimize the number of advice letters. The request for each project should be based on the recorded cost, capped at the estimated cost as detailed in the Settlement.

While approving the proposed advice letter procedures for use here, we note that this type of filing tends to mask the true magnitude of the GRC rate increases. While the stated total increase granted by this decision is approximately \$20 million over the three-year rate case period, capital project advice letter filings could increase that amount by another \$2 million to \$3 million.

For the remaining six specified projects, the parties reasonably agreed to the disposition of approximately \$7 million in project costs. Delays, evaluation of ORA's analysis and uncertainty related to health regulations resulted in SJWC agreeing to reduce costs related to five projects by approximately \$5 million. On the other hand, ORA agreed that SJWC provided enough additional information to justify a \$2 million project.

f. Depreciation

As part of the Settlement, SJWC withdraws its request to convert to a computerized straight-line depreciation methodology. ORA opposed the new methodology, and the Settlement agreement that SJWC will continue to follow the Commission's Standard Practice U-4 to calculate straight-line remaining life depreciation is reasonable.

g. Rate Base

The Settlement rate base incorporates the effects of the settled items above and, as such, is reasonable.

h. Rate of Return

The only pre-Settlement rate of return dispute was the return on equity (ROE). SJWC requested an ROE of 11.50% on rate base for each of the years 2004 and 2005, while ORA recommended an ROE of 9.18%. The parties settled on an ROE of 9.90%, which is within the range of returns currently authorized by the Commission for California Class A water utilities. There is no persuasive evidence that SJWC's ROE should be significantly higher or lower than that of other Class A water utilities. Therefore, we find that the 9.90% ROE for SJWC is reasonable for test years 2004 and 2005. The adopted rate of return on rate base is 8.86% for both 2004 and 2005, as shown below.

Adopted Rates of Return

	Capital Ratio	Effective Rate	Rate of Return
2004			
Long-term Debt	47.77%	7.73%	3.69%
Common Equity	52.23%	9.90%	5.17%
Rate Base			8.86%
2005			
Long-term Debt	47.58%	7.72%	3.67%
Common Equity	52.42%	9.90%	5.19%
Rate Base			8.86%

i. Attrition

The Settlement's calculated attrition allowance for 2006 is reasonable. The calculation is based on the traditional procedure of applying the operational attrition from 2004 to 2005 to the test year 2005 rate base and grossing that net amount to the revenue increase amount. In this case, there is no financial attrition.

j. Design of Rates

1. Rate Assistance for Low-Income Customers

For the Water Rate Assistance Program (WRAP), the Settlement incorporates ORA's modifications to SJWC's proposal. A 15% discount, rather than the \$5.00 discount proposed by SJWC, will provide equal benefits for larger qualifying households. Customers in master metered residences will be able to receive assistance. Eligibility will be extended to customers who may not have qualified for PG&E's CARE program (because they do not have PG&E service in

their own name) but who are otherwise eligible, as established through income verification. SJWC will implement the program through an advice letter filing and will maintain a separate balancing account to which all revenue and expenses associated with the program will be booked for later recovery or refund. The WRAP adopted in the Settlement is reasonable.

2. Resale Service

The parties' agreement to eliminate the existing discount for Resale Service Schedule No. 6 is reasonable, since the rate differential has not been substantiated by any study showing lower cost of resale service.

3. Private Fire Service

The parties agreement to increase Private Fire Service rates by 30.72% plus the system-wide increases is reasonable, since a study prepared by SJWC shows revenues from current rates are 30.72% below the cost of service provided.

4. Residential Fire Sprinkler Service

Since there is no evidentiary basis for exempting Schedule No. 1B, General Metered Service with Automatic Fire Sprinkler Systems, from the GRC increase adopted in this proceeding, the Settlement's use of a system-wide increase for 2004 and 2005 is reasonable.

7. Water Main Relocation Costs

VTA claims that the water main relocation projects necessitated by the construction of its light rail transit lines provide a benefit to SJWC customers by extending the life of the water mains or improving the operation of the water system. VTA therefore requests that \$5.5 million of its relocation costs be refunded and recovered through water rates as additional rate base. As discussed below, since we find that the ratepayer benefits of the relocation projects are minor in comparison to the costs, we deny VTA's request.

a. Background

VTA, in its PHC Statement, indicated that it would seek ratepayer reimbursement for 100% of its payment to SJWC for the cost of relocating certain water mains during the construction of its light rail transit facilities on the Tasman, Capitol and Vasona corridors. At the PHC, the details of VTA's request were discussed. Certain aspects were unclear, and pursuant to the Assigned Commissioner's Scoping Memo and Ruling, VTA filed a preliminary brief and report on its request.

In its preliminary brief, VTA stated, "Upon an assignment of rights from SJWC, VTA is entitled to participate in this case for the limited purpose of determining whether and to what extent relocation costs can be included into the rate base." VTA's preliminary report on ratemaking states that it is requesting that the Commission direct SJWC to refund VTA's contributions in aid of Construction (CIAC) for the projects, which totaled \$15.7 million to that date, and to direct SJWC to pay the remaining costs of the Vasona relocations. Those reimbursements and remaining costs would then be included in rate base and recovered from ratepayers through increased customer rates.

Both SJWC and ORA responded to VTA's filing. SJWC stated that, through its proposal, VTA sought to breach its August 2000 contract with SJWC, and that the Commission should deny the request. Specifically, SJWC claimed that no assignment of rights ever took place and that VTA agreed to seek reimbursement of only 50% of the costs and only from SJWC's customers, not the company itself. ORA stated that VTA has not justified burdening ratepayers with paying for water main relocation costs incurred to build a transit system. ORA asserted that utility ratepayers realize little or no benefit from the relocation

and that none of the authority cited by VTA established a VTA right to receive ratepayer reimbursement for relocation costs incurred to build its transit system.

VTA's direct testimony modified the preliminary report in that the testimony requested 50%, rather than 100%, of the water main relocation costs be included in rate base and refunded to VTA. Also, VTA provided analysis that indicated SJWC ratepayers receive a benefit of about 39% of the total project cost, primarily because the new pipes extend operating life relative to the existing pipes. The analysis considered three factors: pipe age and material, pipe length and new facilities providing new functions or enhanced benefits.

SJWC's rebuttal to VTA's testimony stated that ratepayers have already paid for a portion of the costs for the Vasona 326/346 segments; the rebuttal adjusted VTA's benefit analysis accordingly. SJWC further adjusted the VTA analysis to reflect the time value of money, zero ratepayer benefit for new fire hydrants and a reduced benefit for parallel mains. SJWC concluded that approximately 4% of the total main relocation costs at issue benefited ratepayers, and that this incidental benefit did not justify SJWC's ratepayers paying for any of the relocation costs.³

³ Following submission of prepared testimony, ORA moved to dismiss VTA's request, contending that VTA has no standing to request that SJWC's rate base be expanded. ORA asserted that the relocation agreement between SJWC and VTA does not assign VTA the right to seek Commission approval for a rate base increase and, for many reasons, SJWC cannot assign that right to VTA. ORA also expressed an equity concern regarding the benefits of the relocation projects.

In response, VTA argued that whether or not the contract assigns the right for VTA to make its request for a rate base increase, VTA has the right to be heard on its benefit analysis. An ALJ Ruling, dated January 29, 2004, recognized the validity of benefit analyses to determine cost responsibility; insofar as VTA's request was based on a benefit analysis, the ruling denied ORA's motion to dismiss. The ruling granted ORA's

Footnote continued on next page

In its opening brief, VTA acknowledged that its calculations should be corrected to exclude the Vasona 326/346 segments, and indicated that the ratepayer benefit would then be \$5.5 million, which is 37.4% of the remaining \$14.6 million in relocation project costs. VTA argued that the other adjustments proposed in SJWC's rebuttal testimony were inappropriate. While VTA has proposed that the \$5.5 million be refunded to VTA by SCWC and included in SJWC's rate base, it indicated that it is not opposed to the use of a surcharge, provided that it is accompanied by a refund of its contribution in aid of construction from SJWC through either a lump sum payment or issuance of a promissory note.

SJWC's position is that any refund to VTA should be through a surcharge to customers. The company, however, concluded that the Commission should deny any rate relief for VTA, since the pipeline relocations provided very little, if any, benefit to SJWC's ratepayers, and any incidental benefit is outweighed by the incremental costs incurred solely as a result of the nature of VTA's light rail projects.

ORA argued that the proper test is to determine who is the "primary beneficiary" of the facilities relocation and have that beneficiary pay the costs. ORA concluded that VTA was the "primary beneficiary" and should pay all the costs. ORA also argued that VTA's request is inappropriate in that it seeks rate base recovery of costs that are neither prudent nor used and useful for providing water utility service.

motion to dismiss, insofar as it struck VTA's assignment of rights theory, noting SJWC's position that no such assignment ever took place and concluding that VTA's argument was unsupported and would not be considered further in this proceeding.

In its reply brief, VTA addressed ORA's "primary beneficiary" argument by indicating that ORA applied the benefit test too narrowly. VTA argued that the real beneficiaries of the light rail transit service provided by VTA are virtually all the residents of the Bay Area. Benefits include reductions of pollution, traffic congestion and commuting stress. VTA concluded that since there is no particular "primary beneficiary," it is reasonable to allocate 37.4% of the costs to SJWC.

b. Discussion – Ratemaking Considerations

In seeking reimbursement for utility relocation costs, VTA presents two scenarios. First, in cases where a jurisdiction, such as a city, has granted a franchise to a utility for transmitting and distributing utility service within the limits of the municipality, § 6297 specifically requires the utility to relocate its facilities at no cost to the municipality. While VTA asserts that it has such authority under § 100164 of its enabling act, it also recognized that SJWC did not agree with that proposition. VTA indicates that a compromise with SJWC was struck in July 2000 to allow VTA the opportunity to seek rate base recovery of 50% of its relocation costs. However, VTA states that if the Commission agrees that VTA has the franchise authority of a municipality it could apply *City of Livermore v. Pacific Gas and Electric*, 51 Cal.App.4th (1997), which requires the utility to relocate its facilities at its own expense.

VTA did not grant a franchise to SJWC. Section 6297 is therefore not directly applicable in this case, since it is predicated on a franchise agreement. However, in arguing that its enabling act did grant it the same right for utility relocation at no cost, as granted to municipalities, VTA cites § 10064, which states:

“The district [VTA] may construct and operate or acquire and operate transit works and facilities in, under, upon, over, across, or along any state or public highway or any stream, bay or water course, or over any of the lands which are the property of the state, to the same extent that such rights and privileges appertaining thereto are granted to municipalities within the state.”

While granting VTA the authority to construct and operate transit facilities to the same extent such rights are granted to municipalities, VTA’s enabling act is silent as to whether VTA specifically has the right to require utility relocations at no cost to the district. If that were the legislative intent, the legislation could have so specified, as it did for other granted rights. For instance, regarding eminent domain, § 100131 states:

“The district may exercise the right of eminent domain to take any property necessary or convenient to the exercise of the powers granted in this part. The district, in exercising such power, shall in addition to the damages for the taking, injury, or destruction of property, also pay the cost, exclusive of betterment and with credit for salvage value, of removal, reconstruction, or relocation of any structure, railways, mains, pipes, conduits, wires, cables, or poles of any public utility which is required to be moved to a new location.”

The code is therefore specific as to VTA’s eminent domain rights. Without such specificity as to the applicability of the franchise requirement for relocation cost responsibility, and without the benefit of any supporting Commission or Court decisions on the subject, we cannot conclude that VTA has the right, similar to that for municipalities under § 6297, for utility relocations to be provided at no cost to the district.

The second scenario presented by VTA is where a public agency does not have a franchise agreement with the utility and a benefit test is employed to

determine cost responsibility. D.01-07-010 states, “In other words, where a franchise is not determinative, a court may look to the primary beneficiary to absorb the costs of a public works improvement.” (mimeo, p. 13) Consistent with this principle, the January 29, 2004 ALJ Ruling determined that VTA’s request, as it relates to benefit analysis, would be considered in the GRC.

While ORA and VTA agree that the benefit test adopted by D.01-07-010 should be applied in this case, ORA argues that, even by VTA’s own analysis, VTA is the “primary beneficiary” and as such should absorb all costs. ORA correctly points out that D.01-07-010, as well as related decisions, determined a primary beneficiary and assigned all costs to that party. There were no allocations between the utilities and public agencies. However, strict interpretation of D.01-07-010 appears harsh, since VTA has submitted testimony and analysis that support its claim that the relocations provide a ratepayer benefit amounting to 37.4% of the project costs. For discussion purposes, we are willing to consider VTA’s benefit analysis along with SJWC’s related rebuttal testimony.

c. Discussion – Ratepayer Benefits

From the evidence provided in this case, it appears that the vast majority of VTA’s quantified benefits, as well as SJWC’s adjustments, are related to the extended life of the relocated mains. SJWC asserts that the benefits of the extended life of the pipe do not occur until the current life of the existing pipe is completed. Since this benefit is a future benefit, the value of this benefit must be brought to the present using a present worth calculation that accounts for the time value of money. SJWC used what it called a “conservative” investment rate of return of 6% and subtracted an assumed annual inflation rate of 3%, yielding a

net discount rate of 3%. There is a strong theoretical basis for SJWC's adjustment and we will include it in evaluating the benefit analyses.

While VTA does not dispute the time value of money theory or the specific factors used by SJWC, it does argue that the newer replaced mains provide enhanced reliability over that of the replaced pipes. Since those benefits can be immediate, VTA concludes that there is no reason to discount any of the benefits by SJWC's time value of money adjustment. We find this logic unconvincing. There is no evidence that quantifies the reliability benefit or shows it to be immediately significant when compared to the time value of money adjustment. SJWC believes that the reliability benefit is very small and is more than offset by the added costs required by the nature of VTA's project, such as additional installation and maintenance costs. If the reliability adjustment were significant, both in value and timing, that proposition should have been included in VTA's analysis with supporting information. Without such evidence, tested by cross-examination, we cannot reject or reduce SJWC's time value of money adjustment.

Our use of SJWC's time value of money adjustment significantly reduces the ratepayer benefits related to the water main relocation projects. According to SJWC's witness this adjustment had by far the largest effect in reducing VTA's estimated benefit from 39% to 4.7%. The second largest effect was the result of SJWC's adjustment to account for its agreement to fund a portion of the Vasona project costs. In agreeing that the Vasona adjustment was appropriate, VTA reduced its estimated benefits from 39% to 37.4%.

SJWC also included adjustments that reflect (1) a zero value for new fire hydrants, based on reasoning that new hydrants are a requirement of the City of San Jose Fire Department specifically for VTA's projects, and (2) removal of parallel main benefits in excess of the original main crossing, since the new

mains were installed as a cost saving benefit to VTA to minimize the number of costlier crossings beneath the new light rail lines and are not an added benefit to ratepayers. There is merit to these adjustments, the inclusion of which would further reduce the estimated ratepayer benefits. Although the dollar effect of each adjustment it is not clear, it appears they are comparatively minor to that of the time value of money or Vasona adjustments.

SJWC also mentions but does not quantify in its analysis the effects of additional costs specific to VTA projects, decreased lifespan due to stray current, increased liability, higher future piping replacement costs and an overstatement of the value of hydrant heads. On the other hand, VTA asserts that its analysis is conservative, specifically citing the use of a 1.0 pipe factor when, in a number of instances, higher numbers might have been justified.

While the evidence in this proceeding does not provide sufficient detail to precisely quantify the ratepayer benefit, we do find that the ratepayer benefit, associated with the water main relocations at issue, is much closer to the 4.7% estimated by SJWC than to the 37.4% now estimated by VTA. A rough estimate would be within the range of 0% to 10%, depending on what is assumed regarding non-quantified benefits or adjustments. Therefore, we find that VTA is the primary beneficiary of the water main relocation projects at issue and conclude that all related costs in dispute should be assigned to VTA.

8. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with § 311(d) of the Public Utilities Code and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed on _____, and reply comments were filed on _____.

9. Assignment of Proceedings

Loretta M. Lynch is the Assigned Commissioner and David K. Fukutome is the assigned ALJ in this proceeding.

Findings of Fact

1. The Settlement's resolution of issues related to unaccounted-for water, operation and maintenance expenses, administrative and general expenses, balancing and memorandum accounts, depreciation and rate base is reasonable.

2. If SRF funding is denied for two capital projects that are prudent, necessary and in the public interest, the Settlement's proposal to allow SJWC to recover the plant costs through advice letter filings is reasonable.

3. For six specified capital projects that are prudent, necessary and in the public interest, but where the timing of construction is not certain, the Settlement's proposal to allow SJWC advice letter recovery for the completed plant costs is reasonable.

4. The Settlement's resolution of other plant issues is reasonable.

5. The Settlement's proposed rate of return on equity of 9.9% is within the range of returns currently authorized by the Commission for Class A water utilities and is reasonable.

6. There is no financial attrition from 2004 to 2005.

7. The Settlement's proposed attrition allowance for 2006 includes the effects of operational attrition from 2004 to 2005 and is reasonable.

8. The Settlement's proposals for rate assistance for low-income customers and the rate design for resale service, private fire service, and residential fire sprinkler service are reasonable.

9. The Settlement is reasonable and in the public interest.

10. SJWC's proposal to recover costs accumulated in the Water Contamination Litigation Memorandum Account and the undercollection in the Balancing Account is unopposed.

11. VTA's assertion that it has the franchise authority of a municipality, as it relates to § 6297, is unsupported.

12. The use of a benefit analysis to determine cost responsibility for water main relocation projects is consistent with prior Commission decisions and is reasonable.

13. While prior Commission decisions have assigned all costs to the primary beneficiary of the project at issue, it is reasonable to consider an allocation of the costs between parties, if an allocation more fairly resolves the issue and the record supports such an allocation.

14. SJWC's time value of money adjustment to VTA's benefit analysis is reasonable and substantially reduces the estimated ratepayer benefit. There is also merit to SJWC's adjustments related to new fire hydrants and parallel mains.

15. Both SJWC and VTA mention, but do not quantify, factors that would either decrease or increase the estimated ratepayer benefit.

16. The ratepayer benefit related to the water main relocation projects at issue is much closer to SJWC's estimate of 4.7% of the project costs than to VTA's estimate of 37.4% of the project costs. As such VTA is the primary beneficiary.

Conclusions of Law

1. The Settlement is lawful and should be adopted.
2. SJWC should be allowed to establish surcharges to recover, over a twelve-month period, the costs accumulated in the Water Contamination Litigation Memorandum Account and the undercollection in the Balancing Account.

3. All water main relocation project costs at issue in this proceeding should be allocated to VTA.
4. VTA's request for additional ratepayer funding of water main relocation costs should be denied.
5. Today's order should be made effective immediately.

O R D E R**IT IS ORDERED that:**

1. The San Jose Water Company (SJWC) and Office of Ratepayer Advocates settlement (Settlement), dated January 26, 2004 and revised March 8, 2004, is adopted.
2. Santa Clara Valley Transportation Authority's request that ratepayers fund additional water main relocation costs is denied.
3. SJWC is authorized to file in accordance with General Order 96, and make effective on not less than five days' notice, the revised tariff schedules for 2004 included as Appendix B to this order. The revised tariff schedules shall apply to service rendered on and after their effective date.
4. Advice letters for authorized rate increases for 2005 and 2006 shall be filed in accordance with General Order 96, no earlier than November 1 of the preceding year. The filing shall include appropriate work papers. The increase shall be the amount authorized herein, or a proportionate lesser increase if SJWC's rate of return on rate base, adjusted to reflect rates then in effect, normal ratemaking adjustments, and the adopted change to this pro forma test, for the 12 months ending September 30 of the preceding year, exceeds the lower of (a) the rate of return on rate base found reasonable by the Commission for SJWC for the preceding year in the then most recent rate decision, or (b) the return on rate base authorized herein for the preceding year. The advice letters shall be reviewed by the Commission's Water Division for conformity with this decision, and shall go into effect upon Water Division's determination of compliance, not earlier than January 1 of the year for which the increase is authorized, or 30 days after filing, whichever is later. The tariffs shall be applicable to service rendered on or after the effective date. The Water Division shall inform the Commission if

it finds the proposed increase does not comply with this decision or other Commission requirements.

5. SJWC is authorized to file advice letters seeking Commission authorization for rate offsets for the capital projects specified in Sections 6.2 through 6.15 of the Settlement adopted by this decision. SJWC is authorized to file one such advice letter in each of the years 2004, 2005 and 2006. Each advice letter filing shall be made after the projects contained in the filing have been completed and placed in service, with costs for each project not to exceed that specified in the Settlement.

6. As set forth in Appendix F, SJWC is authorized to implement surcharges for recovery of \$70,606 from the Water Contamination Litigation Memorandum Account and \$328,068 for the undercollection in the Balancing Account.

7. Application 03-05-035 is closed.

This order is effective today.

Dated _____, at San Francisco, California.