

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



April 23, 2007

Draft Resolution No. W-4647
Agenda ID #6599

TO: Parties to San Jose Water Company's Advice Letter No. 372

This is the draft Resolution of the Water Division. This draft Resolution will be on the agenda of the Commission's May 24, 2007 meeting. The Commission may act then, or it may postpone action until later.

When the Commission acts on a draft Resolution, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare a different Resolution. Only when the Commission acts does the Resolution become binding on the parties.

Parties may submit comments on the draft Resolution. An original and two copies of the comments, with a certificate of service, should be submitted to:

Fred L. Curry
Water Division
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102
Fax: (415) 703-2655

Any comments on the draft Resolution must be received by the Water Division by May 14, 2007. Those submitting comments must serve a copy of their comments on 1) the service list attached to the draft Resolution, 2) all Commissioners, and 3) the Director of the Water Division, on the same date that the comments are submitted to the Water Division.

Comments shall be limited to five pages in length plus a subject index listing the recommended changes to the draft Resolution, a table of authorities and an appendix setting forth the proposed findings and ordering paragraphs.

Comments shall focus on factual, legal or technical errors in the draft Resolution. Comments that merely reargue positions taken in the advice letter or protests will be accorded no weight and are not to be submitted.

Late submitted comments will not be considered.

/s/ KEVIN P. COUGHLAN

Kevin P. Coughlan
Director
Water Division

Enclosures: Draft Resolution W-4647
Certificate of Service
Service List

WATER/FLC/SNR/PTL/HJL/jrb

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

WATER DIVISION

ESOLUTION NO. W-4647

May 24, 2007

R E S O L U T I O N

(RES. W-4647), SAN JOSE WATER COMPANY (SAN JOSE). ORDER AUTHORIZING THE ACQUISITION OF REDWOOD MUTUAL WATER COMPANY (REDWOOD MUTUAL), NOW SAN JOSE'S MOUNTAIN DISTRICT, AND AUTHORIZING RATE INCREASES TO FINANCE PLANT IMPROVEMENTS FOR MOUNTAIN DISTRICT.

SUMMARY

By Advice Letter (AL) Number (No.) 372, filed on December 1, 2006, San Jose submits for filing tariff Schedule No. 1C, General Metered Service, Mountain District (formerly known as Redwood Mutual Water Company.) These tariffs were submitted in accordance with Paragraph 6 of the Second Amendment to the Agreement for Purchase and Sale of Water System (Agreement) between Redwood Mutual and San Jose as submitted in Attachment A to AL No. 365-A authorized by the Commission on June 16, 2006.

Paragraph 6 of the Second Amendment states:

"Water Rates for Calendar Year 2007. The water rates established by the Redwood Board for the Calendar year 2006, as set forth in Section 9.6 of the Original Agreement, shall be increased as of January 1, 2007, by the following percentages:

Service Charges shall be increased by Two Percent (2.00%)
Commodities Charges shall be increased by Ten and Three
Tenths Percent (10.3%)."

The bill for the average residential customer using 11 Ccf (One Ccf is equal to 100 cubic feet) per month will increase from \$108.55 to \$113.46 or \$4.91 per month, or approximately 4.5%.

BACKGROUND

By AL No. 372, San Jose, a Class A water utility, requests authority under Section VI of General Order 96-A and Section 454 of the Public Utilities Code to increase water rates for its Mountain District by 4.5%. The purpose of the rate increase is to help pay for capital improvements to be made within 18 months after the close of sale.

System Description:

San Jose's Mountain District serves 375 customers in the Redwood Estates Community of Los Gatos. The current boundary is located approximately one mile south of the existing service area boundary of SJWC. The Mountain District water is supplied by San Jose through its Montevina Pipeline from San Jose's Montevina Treatment Plant. The Montevina main delivers water to Redwood Estates and to 450 additional residences in the following seven mutual water companies located outside the Mountain District service area: Brush & Old Well, Villa Del Monte, Oakmont, Stagecoach Road, Summit West, Gillette, Ridge, and Big Redwood Park.

The Mountain District distribution system includes four storage tanks, two pump stations and approximately six miles of piping. The Montevina Pipeline consists of three pump stations and six miles of 8-inch water main. Due to the limited capacity of the Montevina Pipeline and operational constraints, customers of the Mountain District are currently urged to limit water use to 250 gallons per day (gpd) through the use of a six block tiered rate structure. The system is generally in good condition and well maintained, but contains several low pressure areas (less than 40 pound per square inch (psi) at the meter) as outlined in the purchase agreement.

Also, although the Santa Clara County Fire Department has tested and accepted each hydrant flow, some hydrant flows are less than the alternative minimum of 250 gallons per minute (gpm) established in Commission's General Order No. 103 (G.O. 103). Finally, most of the piping is smaller than the minimum of 6-inch prescribed in G.O. 103 (2-inch and 4-inch piping). For these reasons, system upgrades are necessary.

Purchase Agreement:

On December 14, 2005, San Jose and Redwood Mutual entered into a purchase agreement for the sale of Redwood Mutual to San Jose. The execution of the purchase agreement was conditioned upon approval by the membership of Redwood Mutual, as well as review by the Commission. Subsequently, on February 15, 2006, the Redwood Mutual shareholders approved the agreement by a two-thirds majority vote.

The purchase agreement established a purchase price of \$569,000 to be paid to Redwood Mutual by San Jose. In exchange Redwood Mutual will deed \$569,000 accumulated in Redwood Mutual's Capital Reserve Fund to San Jose as a contribution in aid of construction. The agreement also establishes a series of commitments by San Jose to Redwood Mutual for capital improvements, specifically, within 18 months after the close of sale.

NOTICE, PROTESTS, AND PUBLIC MEETING

Throughout the negotiation process the members of the Redwood Estates community received notices of the proposed sale of Redwood Mutual to San Jose by means of hand-delivered flyers and notices posted prominently throughout the community. Additionally, the following public meetings were conducted:

- September 21, 2005: The Redwood Mutual board of directors publicly announced their intentions to sell the water system assets at a gathering of residents of Redwood Estates. San Jose made a presentation to the residents and distributed a frequently asked question form.
- September 23, 2005: San Jose made a presentation to the seven wholesale water companies serviced by Redwood Mutual.
- October 3, 2005: Members of the Redwood Mutual board of directors and San Jose conducted a panel discussion, with approximately 200 residents of Redwood Estates.
- November 4, 2005: San Jose participated in a panel discussion conducted by a small group of Redwood Mutual stockholders who were opposed to the transaction. Approximately 45 residents attended.
- December 12, 2005: Members of the Redwood Mutual board of directors and San Jose conducted a panel discussion, with approximately 12 former officers of the Redwood Mutual board to respond to questions.
- December 14, 2005: Members of the Redwood Mutual board of directors and San Jose conducted a panel discussion, with approximately 120 residents of Redwood Estates, to respond to questions.

- January 9, 2006: San Jose and members of the Redwood Mutual board of directors met with the seven wholesale water companies serviced by Redwood Mutual, to discuss the proposed transaction.
- February 6, 2006: Members of the Redwood Mutual board of directors conducted a final panel discussion, with approximately 70 residents of Redwood Estates to answer questions.

In addition, the Redwood Mutual board of directors updated Redwood Mutual's web page weekly with answers to questions and other pertinent information.

There were two protests to AL No. 372, both by electronic mail: one from the President of Ridge Mutual Water Company, and one from a member of Gillette Mutual Water Company. Both Ridge and Gillette are mutual water companies that buy water from Redwood Mutual. Both protested the increase in rates, and the Ridge Mutual Water Company protest requested hearings.

DISCUSSION

San Jose purchased Redwood Mutual and filed AL No. 365 on April 11, 2006 to record the purchase and requested immediate implementation of rates in accordance with paragraph 4.02 and 4.03 of the Settlement (Appendix D) to Decision (D.) 99-10-064, October 21, 1999 in the Acquisition and Mergers Rulemaking (OIR 97-10-048).

Paragraphs 4.02 and 4.03 state:

“4.02 Filing of Rates. The Parties agree that the acquiring utility should be authorized to file an advice letter placing into effect the existing rates of its adjacent or nearby water system, the acquired system's rates, or rates lower than either.

4.03 Notice. Notice of a proposed acquisition should be given to all affected customers at the time when any advice letter or application is filed with the Commission. Additionally, the notice should contain a comparison of the rates before the acquisition and for the first year after the acquisition and identify any cost, including a reasonable return, not fully reflected in the first year's rates. With respect to the acquisition of a water system of a municipality, similar notice should be given to all affected customers.”

Unfortunately neither the utility nor staff recognized the effect of ordering paragraph 2 of that decision on paragraph 4.02. Ordering paragraph 2 states:

“2. The rules set forth in Appendix D, as clarified by this decision with respect to the requirement that a Commission decision or resolution authorizing rates is a prerequisite to the implementation of rates for an acquired utility, are established as the operating procedures in accordance with Pub. Util. Code §§ 718, et. seq., the Public Water System Investment and Consolidation Act of 1997, effective January 1, 1998.”

No resolution was ever adopted implementing the requested rates for San Jose’s Mountain District.

SJWC purchased Redwood Mutual via AL No. 365-A and now seeks to adjust its rates upward. Seven mutual water companies purchase water from Redwood Mutual for resale. Two of these organizations are opposed to the rate increase. The rights of resellers of public utility water are the same as those of end-use customers, at least in so far as ratemaking issues before the Commission are concerned. As such those rights must be addressed in the advice letter and this resolution is the result.

AL No. 365-A was not served on the seven mutual water companies. However, AL No. 372 was. We will address in the resolution the question of rates we should have addressed in AL No. 365-A.

While no resolution was written approving AL No. 365-A, a review of the work folder shows that the filing itself was extensively reviewed by staff. It contains the original AL No. 365 that requested “authority... to continue the existing rates for water service charged by the Redwood Mutual Water Company (RMWC) to its customers...” The original AL also discussed the capital improvements set out in the sales agreement and delineated the notice provided (much of which is included above). It had appended five attachments, including the Agreement, a map of the area, and the rates charged to the customers in the Mountain District and charged to the seven mutuals. The supplemental AL No. 365-A includes the First and Second Amended Agreements to the Purchase and Sale Agreement.

Additionally staff sent San Jose a data request with five questions. The response to the data request includes the Capital Replacement Study, August 2005, by Freitas + Freitas Engineering and Planning Consultants, Inc., a justification for each of the water system improvements and a Summary of Earnings at current rates for years 1 and 5. The Summary of Earnings showed expected realized rate of return with the capital additions and negotiated rate increase to be below the last authorized rate of return for San Jose (7.08% and 7.17% compared to 8.86% authorized). The AL No. 365-A filing provided adequate information to allow the evaluation of and to justify the proposed rates.

The Agreement established a series of commitments by San Jose to Redwood Mutual for capital improvements. Specifically, within 18 months after the close of sale, San Jose was to:

1. Ease the usage restriction to 375 gpd (currently 250 gpd/customer) by installing a 125,000 gallon storage tank adjacent to Pump Station #4 and replacing the booster pumps at Pump Station #5 with new pumps producing 500 gpm (currently 320 gpm). (\$375,000)
2. Provide groundwater, as an additional source, to the Montevina Pipeline by upgrading production facilities at SJWC's 7-Mile Station in San Jose. (\$500,000)
3. Provide two trailer-mounted emergency power generators. (\$80,000)
4. Install additional fire hydrants. (\$30,000)
5. Install intrusion alarms at all facilities for Homeland Security, connected to a Supervisory Control and Data Acquisition System (SCADA.) (\$15,000)
6. Install additional high point vent valves. (\$120,000)
7. Upgrade the SCADA System. (\$132,000)
8. Replace the water main on Virginia Dr. (\$100,000)
9. Contribute toward future projects in the years 2007 to 2011. (\$150,000)

System Integration:

The Agreement described how the Redwood Mutual distribution system was to be integrated into San Jose's distribution system and renamed the Mountain District. The Mountain District comprises a new pressure zone to be added to the sixty other pressure zones already in San Jose's distribution system. San Jose employs its SCADA system to monitor and control the pumps and collect tank levels and other parameters in the Mountain District. The San Jose Water Quality Department staff is responsible for sampling and compliance with all water quality regulations. All of the other resources within San Jose are used to conduct the normal business functions such as customer service, billing, maintenance, engineering, accounting, financing, purchasing, meter reading, and regulatory compliance.

Rates:

The tariff pages accompanying AL No. 372 reflected the same tariff structure Redwood Mutual had in effect and as adopted by the Agreement. The tariff structure included a base rate and a six-tier block rate structure.

Although the Mountain District had the same source of supply as other San Jose customers, there was significant additional costs associated with lifting the water to the mountainous Redwood Estates area. Additionally, the Mountain District has urgent capital improvement needs which will be funded through the higher rates. Finally, due to the limited capacity of the Montevina pipeline the rate structure must encourage a 250 gpd per customer limit until system upgrades have been completed. Although the planned system upgrades will improve the daily water usage limit by 50% to 375 gpd for the Mountain District customers, including the mutuals, it is essential to maintain the tiered rate design in order to encourage compliance with the usage limit. The proposed differential in rates between San Jose's current service area and San Jose's Mountain District is justified and reasonable.

In the event of any commission future rate adjustment of the service charges or commodity charges for San Jose's existing service area, in accordance with the Agreement, San Jose will request approval by advice letter from this Commission for a similar percentage rate adjustment for the Mountain District. (For example, if the Commission were to approve an increase by San Jose of 2% to the service charges and 1.5% to the commodity charges for its existing service area, then San Jose will request increases of 2% to the service charge and 1.5% to the commodity charge for the Mountain District).

Conservation

The Commission, through its Water Action Plan, encourages conservation. The Mountain District's six tiered rates are designed to curb excess usage. In accordance with the Agreement, the excess revenue, if any, will be applied to the plant improvements.

COMPLIANCE

San Jose has no outstanding compliance matters pending before the Commission. By acquiring Redwood Mutual, San Jose will apply existing standards and quality of service now in effect for San Jose to Redwood Mutual's customers.

COMMENT

The draft resolution of the Water Division in this matter was mailed to the parties in accordance with Public Utilities Code §311(g). Comments were filed on _____.

FINDINGS

1. The rates contained in the sales agreement for the San Jose acquisition of Redwood Mutual Water Company, including the increase in proportion to San Jose's rates, are reasonable.
2. The rates requested by Advice Letter No. 372 are reasonable and should be adopted.
3. The rate increase authorized herein is justified and the resulting rates are just and reasonable.

THEREFORE IT IS ORDERED THAT:

1. San Jose Water Company, Inc. is authorized to make effective revised Schedule No. 1C-General Metered Service - Mountain District, attached to Advice Letter No. 372, and to concurrently cancel the corresponding presently effective rate schedule.
2. This resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on May 24, 2007; the following Commissioners voting favorably thereon:

STEVE LARSON
Executive Director

CERTIFICATE OF SERVICE

I certify that I have by mail this day served a true copy of draft Resolution No. W-4647 on all parties in these filings or their attorneys as shown on the attached list.

Dated April 23, 2007, at San Francisco, California.

/s/ JOSIE R. BABARAN

Josie R. Babaran

NOTICE

Parties should notify the Water Division, Public Utilities Commission,
505 Van Ness Avenue, Room 3106, San Francisco, CA 94102,
of any change of address to insure that they continue to receive documents.
You must indicate the Resolution number of the service list on which your
name appears.

SERVICE LIST
DRAFT RESOLUTION NO. W-4647

City of San Jose
Municipal Water Dept.
Attn: Mansour Nasser
3025 Tuers Road
San Jose, CA 95121

California Water Service Co.
Attn: Stan Ferraro
1720 North First Street
San Jose, CA 95112

City of Cupertino
10300 Torre Avenue
Cupertino, CA 95014

City of Campbell
70 North First Street
Campbell, CA 95008

City of Santa Clara
1500 Warburton Avenue
Santa Clara, CA 95050

Great Oaks Water Company
Attn: Vicki Morse
PO Box 23490
San Jose, CA 95153

Community Development Eng. Services
City of Milpitas
Attn: Utilities Section
455 East Calaveras Blvd.
Milpitas, CA 95035

Santa Clara Valley Water District
5750 Almaden Expressway
San Jose, CA 95118

San Jose Mercury News
Attn: Financial Editor
750 Ridder Park Drive
San Jose, CA 95190

Town of Los Gatos
Attn: Director of Public Works
110 E. Main Street
Los Gatos, CA 95032

City of Monte Sereno
Attn: Director of Public Works
18014 Saratoga-Los Gatos Road
Monte Sereno, CA 95030

City of Saratoga
Attn: Director of Public Works
13777 Fruitvale Avenue
Saratoga, CA 95070

County of Santa Clara
Attn: Director of Public Works
70 W. Hedding Street
San Jose, CA 95110

Brush & Old Well Mutual
Water Company
20732 Brush Road
Los Gatos, CA 95030

Gillette Mutual Water Company
21976 Gillette Drive
Los Gatos, CA 95033

Oakmount Mutual Water Company
PO Box 31536
Stockton, CA 95213

Summitt West Mutual Water Company
PO Box 974
Los Gatos, CA 95031

Ridge Mutual Water Company
22316 Citation Drive
Los Gatos, CA 95033

Villa Del Monte Mutual
Water Company
PO Box 862
Los Gatos, CA 95031

Big Redwood Park Water
& Improvement Assoc.
18522 Mt. View Avenue
Los Gatos, CA 95033

San Jose Water Company
Attn: Palle Jensen
374 W. Santa Clara Street
San Jose, CA 95196