

Decision 08-10-018 October 2, 2008

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
Approving the Sale of the Main Office under
Section 851 and Authorizing the Investment of
the Sale Proceeds under Section 790.

Application 07-01-035
(Filed January 22, 2007)

**DECISION ADDRESSING SAN JOSE WATER COMPANY'S
APPLICATION FOR AUTHORITY TO SELL MAIN OFFICE**

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**DECISION ADDRESSING SAN JOSE WATER COMPANY'S
APPLICATION FOR AUTHORITY TO SELL MAIN OFFICE**

1. Summary

This decision (Decision) grants, in part, San Jose Water Company's (SJWC's) Application (A.) 07-01-035 (Application) requesting an order approving the sale of its main office¹ (Main Office) pursuant to § 851 of the Public Utilities Code² and authorization to reinvest the net proceeds from the sale in infrastructure pursuant to § 790. The Decision's approval of the Application, in part, will ensure that SJWC's facilities are adequate to provide public utility services.

The Decision authorizes SJWC to sell the Main Office because the Main Office is not an adequate or efficient facility, and because the Main Office cannot be remodeled or renovated to make it an adequate facility.

The Decision approves an increase of \$1,133,520 in the revenue requirement for 2008 resulting from the replacement of the Main Office, and approves the proposed rate design to recover 50% of this additional revenue requirement through the service charge component and 50% through the quantity rate component of SJWC's tariffed rates. Approval of the additional revenue requirement results in a rate increase of 1.16% in the service charge component, an increase of 0.42% in the quantity rate component of SJWC's tariffed rates, and an overall rate increase of 0.61%.

¹ The facilities consist of a 15,900 ft² office building and a 5,300 ft² data processing facility annexed to the main office building, for a total of 21,200 ft.² These facilities, the land upon which they are situated and other improvements thereon are referred to as the "main office".

² All statutory references are to the Public Utilities Code unless otherwise indicated.

The Decision finds that, although the Main Office is inadequate, it continues to be necessary and useful property. Therefore, the Decision denies SJWC's request for a determination that the Main Office is no longer necessary or useful, and denies SJWC's request for authorization to reinvest the net proceeds from the sale in infrastructure. Instead, the Decision orders the net proceeds from the sale of the Main Office be allocated to ratepayers and shareholders pursuant to the Percentage Allocation Rule.³

The Decision determines that the ratepayers' share of the net proceeds from the Proposed Transaction is \$1,513,209, and that the ratepayers' share of the net proceeds should be distributed to SJWC's customers through a surcredit on customer bills.

Finally, the Decision finds that SJWC did not require prior Commission approval to purchase 1265 South Bascom Avenue, and that SJWC did not mislead the Commission in violation of Rule 1.1 by failing to notify the Commission that SJWC purchased 1265 South Bascom Avenue in May 2007.⁴

2. Background

The Application requests an order approving the sale of its Main Office located at 374 West Santa Clara Street, San Jose, for \$4 million pursuant to § 851 (Proposed Transaction).⁵ The Application states that SJWC faces the immediate

³ D.06-05-041, OP 1, as modified by D.06-12-043.

⁴ All references to Rules are to Commission's Rules of Practice and Procedure unless otherwise indicated.

⁵ § 851 states, in part:

No public utility other than a common carrier by railroad subject to Part I of the Interstate Commerce Act (49 U.S.C. Sec. 10101 et seq.) shall sell, lease, assign, mortgage, or otherwise dispose of or encumber the whole or any part of its

Footnote continued on next page

problem of a lack of space in its Main Office, that the Main Office lacks adequate security and infrastructure for modern technology, and that the Main Office does not comply with the Americans with Disabilities Act (ADA). However, according to the Application, the Main Office cannot be sufficiently remodeled or expanded because the Main Office has been designated a historic landmark. Therefore, SJWC seeks Commission approval to sell the Main Office.

The Application requests approval of an increase of \$1,870,782 in SJWC's revenue requirement for 2007, which SJWC states would result from implementing its proposed plan to replace the Main Office. This represents an increase of 1.05% above the revenue requirement adopted by Decision (D.) 06-11-015 for SJWC in its most recent general rate case (GRC). SJWC seeks to recover 50% of this additional revenue requirement through the service charge component and the remainder through the quantity rate component of its tariffed rates.

The Application also requests a Commission determination that SJWC's Main Office is no longer necessary or useful, and authorization to reinvest the

railroad, street railroad, line, plant, system, or other property necessary or useful in the performance of its duties to the public...without first having either secured an order from the commission authorizing it to do so for qualified transactions valued above five million dollars (\$5,000,000), or for qualified transactions valued at five million dollars (\$5,000,000) or less, filed an advice letter and obtained a resolution from the commission authorizing it to do so...Nothing in this section shall prevent the sale, lease, encumbrance or other disposition by any public utility of property that is not necessary or useful in the performance of its duties to the public, and any disposition of property by a public utility shall be conclusively presumed to be of property that is not useful or necessary in the performance of its duties to the public...

net proceeds from the sale in infrastructure pursuant to § 790.⁶ According to the Application, the Main Office has reached the end of its useful life.

Notice of the Application appeared on the Commission's Daily Calendar on January 24, 2007. The Division of Ratepayer Advocates (DRA) filed a protest

⁶ § 790 states:

(a) Whenever a water corporation sells any real property that was at any time, but is no longer, necessary or useful in the performance of the water corporation's duties to the public, the water corporation shall invest the net proceeds, if any, including interest at the rate that the commission prescribes for memorandum accounts, from the sale in water system infrastructure, plant, facilities, and properties that are necessary or useful in the performance of its duties to the public. For purposes of tracking the net proceeds and their investment, the water corporation shall maintain records necessary to document the investment of the net proceeds pursuant to this article. The amount of the net proceeds shall be a water corporation's primary source of capital for investment in utility infrastructure, plant, facilities, and properties that are necessary or useful in the performance of the water corporation's duties in providing water utility service to the public.

(b) All water utility infrastructure, plant, facilities, and properties constructed or acquired by, and used and useful to, a water corporation by investment pursuant to subdivision (a) shall be included among the water corporation's other utility property upon which the commission authorizes the water corporation the opportunity to earn a reasonable return.

(c) This article shall apply to the investment of the net proceeds referred to in subdivision (a) for a period of 8 years from the end of the calendar year in which the water corporation receives the net proceeds. The balance of any net proceeds and interest thereon that is not invested after the eight-year period shall be allocated solely to ratepayers.

(d) Upon application by a water corporation with 10,000 or fewer service connections, the commission may, after a hearing, by rule or order, exempt the water corporation from the requirements of this article.

(e) The commission retains continuing authority to determine the used, useful, or necessary status of any and all infrastructure improvements and investments.

on February 23, 2007. A prehearing conference (PHC) was held on March 16, 2007, where SJWC and DRA were in attendance.⁷

On March 30, 2007, the assigned Commissioner issued a Scoping Memo and Ruling (Scoping Memo), identifying the following issues to be considered in this proceeding:

1. Does D.06-05-041 apply to the sale of SJWC's Main Office, and if so, does the Application satisfy the requirements of that decision?
2. Does the Application (that is, the request for permission to sell the Main Office) require Commission approval pursuant to § 851?
3. Should the Commission find that the Main Office and/or other real property being sold are no longer necessary or useful?
4. May SJWC to use the proceeds from the sale of its Main Office building to acquire a new company headquarter and a walk-in customer service facility in downtown San Jose pursuant to § 790?
5. Should the Commission approve the proposed rate increase resulting from this transaction?
6. Should the Commission approve the proposed rate design for recovering the increased costs resulting from the transaction?

The Scoping Memo directed SJWC to address in its supplemental testimony the applicability of D.06-05-041 (Gain on Sale Decision) to the Proposed Transaction, and whether the Application required Commission approval pursuant to § 851. SJWC requested, and was granted by an

⁷ Adrian Hanson, representing himself, was also a party but did not actively participate in the proceeding.

Administrative Law Judge (ALJ) ruling on April 30, 2007, an extension of time until May 7, 2007 to submit its supplemental testimony.⁸

On May 7, 2007, SJWC served its supplemental testimony, which indicated that SJWC had reached agreement on the terms of the purchase of a replacement office building located at 110 West Taylor Street, San Jose (Replacement Facility), for \$6.7 million.⁹ The supplemental testimony states that, although SJWC will pay \$6.7 million for the Replacement Facility, the Application's request for recovery of \$3.795 million is not altered or changed.

SJWC requested and was granted two additional extensions of time to submit its brief on the legal issues identified in the Scoping Memo. On June 15, 2007, the ALJ issued a ruling suspending the schedule and stating his intention to recommend dismissal of the Application (Suspension Ruling), after SJWC failed to submit its brief on legal issues by the established deadlines, or explain why it failed to meet those deadlines or to timely ask for additional time.

On June 25, 2007, SJWC filed a Motion for Reconsideration of the Suspension Ruling (Motion for Reconsideration), and, in doing so, responded to the legal issues identified in the Scoping Memo. The Motion for Reconsideration attached a copy of SJWC's brief on legal issues, entitled, "San Jose Water Company's Report on Legal Issues Set Forth in Scoping Memo" (Brief on Legal Issues).

On September 13, 2007, the assigned Commissioner granted, in part, the Motion for Reconsideration (September 13 ACR). The September 13 ACR

⁸ The April 30 ruling also clarified that SJWC's filing on legal issues should be in the form of a brief.

⁹ Exh. SJWC-2, pp. 2-3.

concluded that the sale of SJWC's Main Office requires Commission approval pursuant to § 851, and that the proceeds from the Proposed Transaction were not eligible for reinvestment pursuant to § 790.

The September 13 ACR lifted the suspension of the proceeding, directed SJWC to indicate whether it wished to proceed with the Application, and, if SJWC stated its interest in moving forward, directed the ALJ to issue a ruling to schedule hearings to address the remaining issues in this proceeding. In response to the September 13 ACR, SJWC informed the Commission that it wished to proceed with the Application.

On October 16, 2007, another PHC was held where SJWC and DRA were in attendance (Second PHC). At the Second PHC, neither SJWC nor DRA recommended changes to the scope of the proceeding. DRA recommended, however, that SJWC be ordered to revise and update the Application because DRA believed the economic and revenue requirement analysis contained in the Application changed as a result of SJWC's purchase of the Replacement Facility for \$6.7 million, a price substantially greater than the \$3.795 million purchase price SJWC requests for inclusion in rate base. DRA also sought to examine what SJWC intends do in the future with the Replacement Facility's excess space that remains after space has been allocated to public utility service.

SJWC stated that it will own and use the Replacement Facility, and that it has no current plans to allow affiliates or others to use any portion of the Replacement Facility. SJWC also stated that the economic analysis and revenue requirement analysis contained in the Application had not changed because SJWC has not changed its request. That is, although SJWC will pay \$6.7 million for the Replacement Facility, its request remains unchanged to include \$3.795 million in rate base for the purchase of the Replacement Facility. SJWC

stated that, if at some point in the future SJWC can justify using more of the Replacement Facility for public utility service, it will make such a proposal in a future proceeding.

The ALJ ruling of October 30, 2007 (October 30 ALJ Ruling) determined that the scope of the proceeding should not be modified to include the issues of cross subsidization or affiliate transactions, and that it was premature to consider in this proceeding how SJWC will use the excess office space that it did not seek to place in rate base. The October 30 ALJ Ruling established a new proceeding schedule for the filing of testimony and for evidentiary hearings.

DRA's testimony was filed November 16, 2007, and SJWC's rebuttal testimony was filed December 5, 2007. Evidentiary hearings (EHs) were held on December 19 through December 21, 2007.

At the EH, SJWC moved to strike a portion of DRA's testimony which addressed affiliate transaction issues that the October 30 ALJ Ruling determined were beyond the scope of this proceeding, and SJWC's motion was granted. On January 3, 2008, the ALJ issued a ruling proposing to strike a portion of SJWC's testimony which responded to the stricken DRA testimony. No objections were received, and on January 18, 2008, SJWC's testimony responding to DRA's stricken testimony was stricken.

The ALJ Ruling of January 17, 2008, granted SJWC's request for an extension of time until January 25, 2008 to file and serve post-hearing opening briefs and February 4, 2008 to file and serve post-hearing reply briefs. Post-hearing briefs were filed on January 25, 2008. The ALJ Ruling of February 4, 2008, granted SJWC's February 4, 2008 request for an extension of time until February 5, 2008 to file and serve post-hearing reply briefs. Reply briefs were filed February 5, 2008.

No oral argument was held, and the proceeding was submitted upon the filing of reply briefs. By ALJ Ruling on March 19, 2008, submission of this proceeding was set aside to receive additional evidence (March 19 Ruling).

At the time the proceeding was submitted, the Division of Water and Audits (DWA) did not have SJWC's Discounted Cash Flow (DCF) analysis model or experience in working with the model. Thus, DWA was not able to assist the Commission to determine the financial and revenue effects resulting from our decisions on certain issues. Therefore, the March 19 Ruling directed SJWC to compute, among other things, the net present value, revenue requirement, rate effects and the ratepayers' share of proceeds from the sale of the Main Office for several scenarios using various assumptions provided by the ALJ. The March 19 Ruling also directed DRA to review SJWC's analyses to verify that SJWC prepared the information as directed, and for SJWC and DRA to jointly file and serve the requested information.

Additional ALJ rulings were issued on March 27, and April 4, 2008, in response to DRA's March 24 and April 3, 2008 requests for clarification of the March 19 Ruling. However, after concluding that utilizing the parties through formal rulings to conduct the needed analyses would be impractical and inefficient, the ALJ ruled on April 9, 2008 that SJWC must file and serve the information it prepared pursuant to the March 19, 27 and April 4 rulings (April 9 Ruling). The April 9 Ruling also relieved DRA of the responsibility to verify that SJWC prepared the information as directed, or for parties to jointly file and serve that information.

The April 9 Ruling instead directed SJWC to provide DWA an electronic copy of the analytical model SJWC used to prepare its cash flow, revenue requirement, rate and related information. SJWC was also directed to provide

instructions and training materials concerning the model and to make SJWC personnel and its consultants available to assist Commission staff understand and operate the model.¹⁰ DWA then used SJWC's model to compute the financial and revenue effects resulting from the resolution of the issues in this proceeding, and the proceeding was again submitted on July 10, 2008.

3. Applicability of § 851 and the Gain on Sale Decision to the Proposed Transaction

Although the Application was filed pursuant to § 851, the Application also states that the Main Office building is no longer useful for utility operations, and requests that the Commission find that the Main Office building is no longer necessary or useful. The Application appeared contradictory in seeking approval to sell necessary or useful utility property pursuant to § 851, while concurrently seeking Commission findings that the property is not necessary or useful and that the net proceeds from the sale are eligible for reinvestment in infrastructure pursuant to § 790. Thus, a threshold issue in the proceeding is whether an § 851 application is required if the Applicant has determined that the property in question is not necessary or useful utility property.

The Scoping Memo sought to clarify this apparent inconsistency by asking if the Application requires Commission approval pursuant to § 851, and whether D.06-05-041 (the Gain on Sale Decision), applies to the sale of SJWC's Main Office. The Suspension Ruling was issued after SJWC failed to respond to these questions in the Scoping Memo.

¹⁰ In response to the April 9 Ruling, DRA sent an electronic mail message asserting its right to seek additional information through data requests, to cross-examine and/or file comments, if any of the information provided to DWA is additional evidence not in the record or requires different analyses from that DRA examined in the proceeding.

The Gain on Sale Decision addresses, among other things, the sale of assets which water utilities believe are no longer necessary or useful, and the reinvestment of those sales proceeds pursuant to § 790. The Suspension Ruling concluded that, because SJWC believed that the Main Office was no longer necessary or useful, the Gain on Sale Decision applied to the Proposed Transaction. The Suspension Ruling also found that the Application did not comply with the Gain on Sale Decision, and stated that a proposed decision would be prepared to dismiss the Application.

The Motion for Reconsideration asserts that the Gain on Sale Decision does not change SJWC's obligation to file a § 851 application before selling property that is still in use as required by § 851 and Commission precedent. The Motion for Reconsideration states that the Suspension Ruling confuses the protocol for determining whether property dedicated to the public good can be sold in the first instance with the protocol for determining how to allocate any gain resulting from the sale of such property.¹¹

The Brief on Legal Issues contends that the Gain on Sale Decision is not applicable to the Application because the scope of Rulemaking (R.) 04-09-003, leading to D.06-05-041, is limited to the allocation of gains from the sale of utility assets but not to the sale of that property.¹² The Brief on Legal Issues asserts that D.04-03-039, as modified by D.04-09-028, established that water utilities must file a § 851 application to obtain permission to sell real property. The Brief on Legal Issues also states that the scope of the Gain on Sale Decision is further narrowed

¹¹ Motion, pp. 2-3. Emphasis in original.

¹² Brief on Legal Issues, p. 1.

in that it deals only with formerly useful utility property, and because the Main Office is still being used for public utility service SJWC is required to file an application pursuant to § 851.

Discussion

Rulemaking (R.) 04-09-003, in general, addressed the allocation of gains on sale of utility assets. However, because § 790 predetermines the allocation of gains from the sale of no longer necessary or useful water utility real property, R.04-09-003 also addressed the implications of § 790 for water utilities, and the relationship of § 790 to § 851. R.04-09-003 states:

“In order to reconcile § 790 and 851, at what point do we require the utility to file an application? If the utility files a § 851 application at the time of the sale and the Commission approves the sale, what must the utility file at the end of the eight years, if anything, to reconcile the net proceeds?”¹³

“Further interpretation of Water Utility Infrastructure Improvement Act of 1995, P.U. Code §§ 789, et seq., is merited. This Commission has not previously considered how to reconcile this statute with our statutory obligations pursuant to Public Utilities Code § 451 and 851.”¹⁴

Thus, R.04-09-003 included in its scope the issue of whether and when a water utility should file a § 851 application to sell utility property.

In prior cases concerning the sale of water utility assets, the Commission has found that either Commission authorization was necessary to sell assets the

¹³ R.04-09-003, p. 29.

¹⁴ R.04-09-003, Finding of Fact 39, p. 49.

Commission determined were necessary or useful utility property¹⁵, or that the assets at issue were not necessary or useful utility property and did not require Commission authority to sell.¹⁶

In particular, D.04-09-028 addresses Southern California Water Company's (SCWC's) application for rehearing of D.04-03-039. D.04-03-039 found that SCWC violated § 851 when in November 1994, without seeking Commission approval, SCWC entered into a lease agreement with the City of Folsom allowing the City of Folsom in perpetuity to lease 5,000 acre-feet per year (AFY) of water rights from SCWC's 10,000 AFY allocation of water from the American River. D.04-03-039 concluded that the lease was void, imposed a fine on SCWC, and ordered 70% of the revenues received under the lease to be credited to SCWC's ratepayers.

D.04-03-039 found that SCWC should have filed a § 851 application even if it believed the assets in question are no longer necessary or useful for utility service, and concluded that SCWC violated § 851 when it failed to gain the Commission's approval prior to effectuating the Folsom lease.¹⁷ Upon rehearing, D.04-09-028 affirmed D.04-03-039's determination that SCWC violated § 851.

In A.01-09-062 et al., the Commission did not have sufficient information to determine whether the properties included in the California Water Service Company's (Cal Water's) real estate liquidation program required § 851 approval, and D.03-09-021 ordered Cal Water, among other things, to file an

¹⁵ See, for example, D.97-08-021, D.03-09-021, D.04-03-039 (modified by D.04-04-069 and D.04-09-028), D.04-07-034, D.05-12-002.

¹⁶ See, for example, D.88-04-068, D.92-12-059, D.05-12-002.

¹⁷ See D.04-03-039, p.51, Conclusions of Law 26 and 32.

application explaining its real estate program and justify removing real property in that program from rate base. Cal Water was also ordered to seek authority to establish an Infrastructure Memorandum Account pursuant to § 790, and to file an application for authority to replace its Chico operations and customer centers. D.05-12-002 subsequently determined that Cal Water's old operations and customer centers were no longer necessary or useful property, and their sale was not subject to § 851.¹⁸

Thus, prior to the adoption of the Gain on Sale Decision, the Commission required, or at least encouraged, water utilities to seek Commission approval before disposing of utility property the water utilities believed was no longer necessary or useful. However, in light of the requirement of § 790 that the full gain on reinvested asset sales of no longer necessary or useful utility property be included in rate base, and considering the experience with the Cal Water application described above, the Commission was concerned about the sale of useful assets by water utility management and reinvestment of the net proceeds from those sales in new assets (churning) as a way to increase rate base and profits.¹⁹

Although the Gain on Sale Decision did not change the requirement of § 851 for utilities to obtain Commission approval before selling necessary or useful property, it established an additional notification procedure to ensure that water utilities which did not file a § 851 application would, at minimum, notify the Commission of their intention to sell property. Among other things, the Gain

¹⁸ See A.03-12-008, A.04-08-017.

¹⁹ D.06-05-041, pp. 62, 71-74.

on Sale Decision requires water utilities to provide 30 days' advance written notice to the Director of the Commission's Water Division (now DWA), as well as to the Director of the Office of Ratepayer Advocates (now DRA) when water utilities intend to sell land, water rights, buildings, or all or a portion of a water system that they determine are no longer necessary or useful. This was to give the Commission the opportunity to respond to the proposed sale and prevent sales of property without Commission approval that is obviously necessary and useful.²⁰

Thus, the Commission retains discretion to review applications for the sale of utility property pursuant to § 851, including sales of assets that water utilities contend are not necessary or useful. Although SJWC asserts the Main Office is no longer useful utility property, the Commission will nonetheless consider the Application pursuant to § 851 in order to determine whether the sale requires Commission authorization.²¹

The Motion for Reconsideration states that the Main Office is still in rate base and generating a revenue requirement, is currently occupied and used to provide service to SJWC's customers, and therefore, SJWC must file a § 851 application before selling property that is still in use.²² The Brief on Legal Issues states that, since the property is clearly being used, there can be no doubt that

²⁰ D.06-05-041, pp. 83-85.

²¹ The notification procedure established by the Gain on Sale Decision does not apply to the Proposed Transaction because SJWC has filed this Application with the Commission pursuant to § 851.

²² Motion, pp. 2-3, 5.

SJWC needs prior Commission approval pursuant to Section 851 to sell that property.²³

The Application states that all corporate functions are located at the Main Office, which also serves as a walk-in center and where customers may pay bills and obtain personal assistance from customer service representatives.²⁴ The SJWC Report on Facilities Consolidation and Main Office Relocation states that an active groundwater well, water-pumping facilities, equipment, and piping associated with the groundwater well located on the Main Office property are used to provide water to the City of San Jose (City).²⁵ The Agreement of Purchase and Sale between SJWC and Adobe Systems, Inc., the purchaser of the Main Office, provides for a license to SJWC which, for a period of time after completion of the sale, permits SJWC to lease the Main Office and to park in the portions of the property.²⁶

The Application, Exhibits, Motion for Reconsideration and Brief on Legal Issues all demonstrate that the Main Office continues to be necessary and useful utility property, not only at the time of sale, but also for a period of time after the sale. Therefore, the Proposed Transaction requires Commission approval

²³ Page 2.

²⁴ Application, p. 2.

²⁵ Exh. SJWC-1, YOO, Attachment B, Agreement of Purchase and Sale, Paragraph B, p. 1. Emphasis added.

²⁶ Exh. SJWC-1, YOO, Attachment B, Agreement of Purchase and Sale, Paragraphs J and K, p. 2.

pursuant to § 851, and the Application is an appropriate means for SJWC to seek Commission approval to sell the Main Office.²⁷

4. The Rate Case Plan (RCP) and the Filing of Applications, Rate Base Offsets or Requests for Other Proceedings Between Scheduled GRCs

DRA contends that selective project-by-project rate increases are not allowed under the rate case plan (RCP) adopted in D.04-06-018 (2004 RCP) or the revised RCP adopted in D.07-05-062 (2007 RCP).²⁸ DRA recommends that the Commission not approve the proposed rate increase resulting from the Proposed Transaction because, according to DRA, this proceeding should determine only whether the Proposed Transaction is justified and reasonable, but not whether the proposed rate increase requested in connection with the Proposed Transaction should be approved.

DRA asserts that the RCP allows water utilities to file GRCs for rate increases once every three years to streamline rate proceedings. DRA states that SJWC recently completed a GRC with new rates effective January 1, 2007, and contends that a selective rate increase for this project is contrary to providing rate stability for SJWC's ratepayers. DRA recommends that any rate increase be considered in SJWC's next GRC.²⁹

²⁷ The Proposed Transaction might also be eligible for filing as an advice letter under the § 851 Pilot Program adopted August 25, 2005 by Resolution ALJ-186, as modified by Resolution ALJ-202, adopted August 23, 2007.

²⁸ Exh. DRA-1, p. 4. DRA Opening Brief, pp. 14-15.

²⁹ Exh. DRA-1, p. 8.

SJWC responds that the RCP does not prohibit water utilities from filing applications more frequently than every three years, if water utilities wish to do so. SJWC contends its request is a rate base offset, not a GRC.³⁰ SJWC states that, while the Commission wanted to streamline the processing of GRCs filed by water utilities, the RCP does not limit water utilities from filing applications, rate base offsets or requests for other proceedings.³¹ SJWC states that, although it could track the costs associated with this Application and seek to recover those costs in a subsequent GRC, it is better to have rates adjusted at the time the transaction is completed.

Discussion

The 2004 RCP states that § 455.2 is the impetus for updating the rate case procedures originally adopted by D.90-08-045. This is because § 455.2 requires the Commission to establish a schedule to require every Class A water corporation to file a GRC application every three years, and the RCP in effect at that time did not provide for a mandatory GRC filing schedule.

D.04-06-018 states that the Commission opened R.03-09-005 to update the RCP adopted in 1990, and that the purpose of the 2004 RCP is to provide Class A water utilities with GRC application content guidance, a filing schedule for all Class A water utilities, and a Commission review and evaluation timeline.³² The RCP is intended to promote timely processing of GRCs, to enable the balancing of the workload of the Commission and its staff over time, and to enable a

³⁰ Exh. SJWC-5, p. 3.

³¹ TR 227:13 -27.

³² D.04-06-018, p. 2. *See also* FOF 2 and COL 1.

comprehensive Commission review of the rates and operations of all Class A water utilities by providing for the acceptance of rate case filings on a specified schedule.³³ Nothing in the 2004 RCP prohibits water utilities from filing non-GRC applications, rate base offsets or requests for other proceedings.

The 2007 RCP refined the 2004 RCP to reflect lessons learned while implementing the 2004 RCP, and to incorporate the 2005 Water Action Plan.³⁴ The 2007 RCP made several significant changes to the 2004 RCP. However, none of those changes limit a water utility's ability to file non-GRC applications, rate base offsets or requests for other proceedings.

For example, the 2007 RCP adopted, among other things, Minimum Data Requirements (MDRs), which water utilities are required to complete as part of their GRC and cost of capital testimony in order to reduce discovery during GRC proceedings. The MDRs include the requirement that utilities list each rate change since the last GRC decision by district, including the date, percentage change to a typical residential customer bill, percentage change to revenue requirement, total dollar change, and citations to authority for each increase, and sum to arrive at cumulative rate change by district since the last GRC.³⁵

The MDR instruction to "list each rate change since the last GRC decision" would be unnecessary if, as DRA contends, utilities were not permitted to seek rate changes between GRCs. Thus, the 2007 RCP anticipates the possibility of rate changes occurring between GRCs, and nothing in the 2007 RCP prohibits

³³ D.04-06-018, Appendix, p. 1.

³⁴ D.07-05-062, pp. 1-4. *See also* FOF 6 and OPs 2-3.

³⁵ D.07-05-062, Appendix A, Attachment 1, Section II.A.8, p. A-23. This requirement is nearly identical to that adopted in D.04-06-018 (Appendix, p. 10).

water utilities from filing non-GRC applications, rate base offsets, or requests for other proceedings. Therefore, we reject DRA's recommendation that any rate increase be considered in SJWC's next GRC.

DRA asserts that the Proposed Decision (PD) errs in its interpretation of the MDRs as discussed above because, according to DRA, the language above refers to any rate changes that were conditionally approved in the previous GRC, including rate base increases, and do not refer to unapproved changes.³⁶

The plain reading of D.07-05-062 and MDRs adopted by that decision do not say what DRA contends they say, and DRA provides no support for its assertion. Therefore, DRA's assertion that the MDRs refer to any rate changes that were conditionally approved in the previous GRC lacks merit.

5. Need for Replacement Facilities

The Application states that there is insufficient space in the Main Office, which diminishes SJWC's service and efficiency, that the Main Office lacks adequate security and infrastructure for modern technology, and that it is not in compliance with the Americans with Disabilities Act (ADA). However, according to the Application, the Main Office cannot be remodeled or expanded because the building is designated a historic landmark. Although SJWC continues to operate out of the facility, the Application states that the Main Office has reached the end of its useful life.

The Application states that SJWC has considered all reasonable alternatives and has determined that the most the most economic option is to

³⁶ Opening Comments of DRA on Proposed Decision of ALJ Smith, pp. 1-2.

dispose of the Main Office facility, purchase a new downtown property to serve as company headquarters and a walk-in customer service center, and consolidate all other functions at SJWC's South Bascom Avenue campus.

SJWC states that it periodically evaluates the resources needed to deliver a high quality, reliable drinking water supply and to maintain a high level of customer service, and in 1998, prepared a Strategic Facilities Plan (SFP) that was updated in 2006. The 2006 SFP evaluated alternatives to either modify existing facilities or relocate staff, and considered a range of alternatives, including:

- Remodeling and renovating the current Main Office to add additional space to accommodate current staffing needs and projected short term growth.
- Consolidating all operations at the South Bascom Avenue campus by constructing a new building to house all employees.
- Consolidating all operations at another site through the purchase or lease of new buildings or land in or around Santa Clara County.
- Bifurcating staff by locating the executive staff in one facility and all other employees in another facility.
- Maintaining a walk-up customer service site in downtown San Jose, while consolidating all other functions at another location.

SJWC retained a consultant to analyze several alternative scenarios, and to compare the capital outlay and net present value (NPV) of each to identify the most economically efficient alternative. The Application presents cost/benefit analyses for renovating the Main Office (the Base Case) and for what SJWC asserts are the two most viable alternatives. SJWC's states that its alternatives analysis was presented in the Application, not to obtain the Commission's advice as to how to address its space needs, but rather to show the process SJWC used

to make its choice so that the Commission could review the reasonableness of SJWC's selection.³⁷

Under the Base Case, current functions would remain in the Main Office building, and the Main Office would be remodeled and renovated to add additional space to accommodate current staff and projected short term growth. SJWC states that it included the Base Case in its analysis as the status quo for comparative purposes, but that the Base Case cannot actually be implemented.³⁸

SJWC states that, under the Base Case, the type and extent of improvements possible to the Main Office building are severely limited due to the building's status as an historic landmark, and that substantial renovation costs would be incurred to modify this space for long-term future occupancy. In the Base Case, SJWC would continue leasing 11,800 ft.² of space on the second floor of 1265 South Bascom Avenue, and would lease an additional 3,980 ft² of space on the first floor of 1265 South Bascom Avenue.

Under Alternative 1, SJWC will sell the Main Office, and employees currently located there will be relocated to a newly leased office in downtown San Jose and to existing facilities on South Bascom Avenue. The facilities at 1221 and 1251 South Bascom Avenue will be renovated, and an additional 10,000 ft² of space will be leased on the first floor of 1265 South Bascom Avenue and renovated to accommodate employees from the Main Office and for future expansion. Alternative 2 is identical to Alternative 1, except that a new office in

³⁷ SJWC Reply Brief, p. 9.

³⁸ TR 191: 1-9 and SJWC Opening Brief, p. 9.

downtown San Jose will be purchased instead of leased, and 1265 South Bascom Avenue will be purchased instead of leased.

SJWC asserts that Alternative 2 is the most economic option. As a result, SJWC seeks approval to sell the Main Office, and approval of the increased annual revenue requirement of \$1,870,782 that will result from implementing Alternative 2. DRA recommends that these requests be denied because, according to DRA, SJWC does not need the additional space, and because SJWC has not selected the lowest cost alternative for ratepayers.

DRA contends that the Application is flawed because SJWC's current and future needs for office space can be accommodated through existing or soon to be available office space.³⁹ DRA states that SJWC does not need the additional space proposed in the Application because the Base Case provides for more space than is actually needed to accommodate the six employees hired after its last GRC and any future growth.

DRA recommends that SJWC be required to remodel its Main Office and use space that will become available at 1251 South Bascom Avenue or lease additional space at 1265 South Bascom Avenue to accommodate future growth.⁴⁰ DRA proposes that the cost of remodeling the Main Office be treated as Construction Work in Progress, accrue interest during construction, and be reviewed in SJWC's next GRC.

DRA states that SJWC's customer growth from 2001 through third quarter 2007 varied from 0.03% in 2002 to 0.7% in 3Q 2007, and that average annual

³⁹ Exh. DRA-1, pp. 10-11. DRA Opening Brief, pp. 1-2, 13, 15-16, 18-19.

⁴⁰ Exh. DRA-1, pp. 7-8. DRA Opening Brief, p. 14.

growth in total employees averaged 2.1% over the same six-year period. DRA contends that the proposed increase in space over the Base Case is unnecessary and inconsistent with the historical growth in customer base or employee levels.⁴¹

SJWC responds that DRA does not appreciate the inadequacies of current employee work spaces, and DRA's assumption that additional employees can simply be housed at an alternative location more than three miles away does not consider departmental adjacency needs.⁴² SJWC states that leasing additional space at the 1265 South Bascom Avenue is not acceptable or feasible due to the organizational inefficiencies this would cause. SJWC contends that separating employees within a department is not appropriate and can cause greater difficulties for the organization.⁴³

SJWC states that there is insufficient space in the Main Office to add to or modify the existing office space, and it has addressed the space shortage by creating inferior workspaces comprised of substandard cubicles in the Main Office and at the Bascom Avenue campus.⁴⁴

SJWC contends that the Main Office cannot be renovated.⁴⁵ SJWC states that the Main Office was designated a City Historical Landmark in 1991, and due to its historic status, the City requires an historic preservation permit to perform any work or cause any work to be performed on it.

⁴¹ DRA Opening Brief, pp. 16-18.

⁴² Exh. SJWC-3, p. 2.

⁴³ Exh. SJWC-3, p. 6.

⁴⁴ . SJWC Opening Brief, p. 4.

⁴⁵ Exh. SJWC-3, pp. 3-5. SJWC Opening Brief, p. 10.

SJWC states that, in 2005, SJWC's request for an historic preservation permit to replace the glass panes on one office to alleviate noise from Santa Clara Street was denied on the basis that the City does not want modifications of any kind made to the building. SJWC also states that a 2003 Environmental Impact Report (EIR) determined that no modifications or changes can or will be permitted anywhere on the building, and that no buildings can be built within 50 feet of the Main Office.

SJWC asserts that the Main Office is located directly under the flight path of Mineta San Jose International Airport traffic, with over 530 aircraft departures and landings per day, and near the major thoroughfares of Highway 87 and Santa Clara Street. SJWC states that the Main Office was built before existing airport and roadway traffic levels were anticipated, and the Main Office is not soundproofed from freeway or airport noise. SJWC contends that, although the work environment inside the Main Office is disrupted by aircraft and freeway noise, the historical status of the building makes it impossible to implement needed sound reduction improvements.⁴⁶

SJWC states that, due to the age and historic landmark status of the Main Office, the building cannot reasonably be renovated to support other upgrades to the building's systems and infrastructure because reinforced concrete and asbestos was used in the original construction of the building. SJWC contends that, as a result, air conditioning, plumbing and heating improvements, or

⁴⁶ Exh. SJWC-1, Yoo, p. 5. SJWC Opening Brief, pp. 5-7, 10.

upgrades to electrical and communications wiring are difficult and costly to make.⁴⁷

SJWC states that the Main Office lacks the security needed to ensure the safety of SJWC's employees and customers because the floor plan provides no effective separation between employees and the public. However, according to SJWC, security enhancements are difficult to make because of the architectural challenges inherent in the building, which make additional security measures cost prohibitive or impossible.

Finally, SJWC asserts that the Main Office does not comply with current ADA requirements because it does not have an elevator, and because ramps, handrails, fixtures, and bathroom stalls do not meet code. SJWC states that an elevator cannot be installed in the Main Office, and an ADA compliant ramp cannot be installed at the main entrance to the building.⁴⁸ SJWC contends that DRA's analysis does not consider the severe limitations of the Main Office, and does not respond to any of SJWC's testimony concerning the near impossibility of renovating the Main Office.⁴⁹

DRA acknowledges that renovating the Main Office would be difficult but contends renovations would be less costly than purchasing a new building.⁵⁰ Concerning SJWC's ability to bring the Main Office into compliance with the ADA, DRA states that SJWC's witness Giordano admitted during hearings that ADA requirements are grandfathered.

⁴⁷ Exh. SJWC-1, Yoo, p. 5-6. SJWC Opening Brief, pp. 9-10.

⁴⁸ Exh. SJWC-1, Yoo, pp. 5-6. SJWC Opening Brief, pp. 10-11.

⁴⁹ SJWC Reply Brief, pp. 2-5.

⁵⁰ Exh. DRA-1, p. 3. DRA Opening Brief, Footnote 3, p. 4.

Discussion

The Main Office cannot be satisfactorily remodeled to provide adequate security, install modern systems and infrastructure technology, provide a quiet work environment, and to ensure ADA compliant access for the disabled because the City will not likely grant historic preservation permits and because of the limitations imposed by the 2003 EIR.

SJWC's need to replace the Main Office has as much to do with providing adequate facilities as it does with providing additional floor space. We must take into account more than floor space needs when considering SJWC's request because factors such as building security, ability to upgrade the building's systems and infrastructure, level of workplace noise, and access for disabled persons with mobility challenges are necessary attributes to ensuring adequate facilities required by § 451.⁵¹ Therefore, even if enough floor space is available under the Base Case, the quality of that space is not sufficient to ensure adequate facilities.

Although the work environment in the Main Office is adversely affected by aircraft and freeway noise pollution, the historical landmark status of the building makes it very difficult, if not impossible, to implement adequate sound reduction improvements. The City denied SJWC's request for an historic preservation permit to replace the glass panes on one office to alleviate noise from Santa Clara Street, and it is not likely that the City will approve far more

⁵¹ Section 451 state, in part, "...Every public utility shall furnish and maintain such adequate, efficient, just, and reasonable service, instrumentalities, equipment, and facilities...as are necessary to promote the safety, health, comfort, and convenience of its patrons, employees, and the public..."

substantial modifications to the building that would be required to reduce noise pollution throughout the Main Office.

The Main Office cannot be renovated to support upgrades to the building's systems and infrastructure for modern technology, including the air conditioning, plumbing, heating, electrical and communications systems, due to the building's design, the materials used to construct it, given the limitations on improvements that can be made to the historic landmark. Thus, the limited remodeling that may be done to the building cannot make the Main Office an adequate or efficient facility.

While DRA acknowledges that renovating the Main Office would be difficult, it contends that renovating the Main Office is less costly than purchasing a new building. Although DRA disagrees that SJWC needs to replace the Main Office, DRA's analysis focuses almost entirely on floor space requirements and not on the adequacy of that space in terms of security, reasonable access for the disabled public, ability to upgrade the building's systems and infrastructure, or the adequacy of the work environment with respect to noise pollution.

It is undisputed that the Main Office does not have an elevator serving the second floor, or that it is not possible to install an elevator to provide access for the physically disabled. There is no dispute that the building's handrails, fixtures, door hardware and restrooms do not comply with ADA requirements, and that the existing interior ramps do not comply with the building code. It is also undisputed that, because the set back from Santa Clara Street does not allow for a ramp at the main entrance to the building, disabled customers and employees must use the rear entrance.

DRA appears to minimize the inadequacies of the Main Office in this regard. For example, during cross-examination of SJWC concerning its ability to bring the Main Office into compliance with the ADA, DRA asked the witness to confirm his understanding that the ADA requirements were grandfathered with respect to the Main Office. In support of its position that renovating the Main Office is less costly than purchasing the Replacement Facility, DRA then cites SJWC's testimony concerning the grandfathered status of Main Office with respect to compliance with ADA requirements.

While DRA does not take an explicit position regarding grandfathered ADA requirements, raising this issue in hearings and citing SJWC's testimony on this issue in its Opening Brief clearly suggests that the current inadequate access for the disabled is acceptable, and SJWC need do nothing further to accommodate persons with physical disabilities.

The inadequate access for the physically disabled to the Main Office cannot be rectified, given limitations to modifications that can be made to the Main Office as a designated historic landmark. If the Commission required SJWC to retain the Main Office, persons with mobility challenges would permanently be required to use the rear entrance to gain access to the building, would never have access to the second floor, and could not use the restrooms. In essence, physically disabled members of the public will be denied reasonable access to SJWC's customer service center, if SJWC were required to retain the Main Office.

Public utilities are required to furnish and maintain such adequate, efficient, just, and reasonable service, instrumentalities, equipment, and

facilities⁵², and no public utility shall, as to rates, charges, service, facilities, or in any other respect, make or grant any preference or advantage to any corporation or person or subject any corporation or person to any prejudice or disadvantage.⁵³ Government Code § 11135, which § 453(b) incorporates by reference, prohibits discrimination against persons with physical disabilities.⁵⁴

Requiring disabled persons to use the rear entrance, ring a bell for access and wait for an escort is inconvenient and possibly demeaning to the disabled public, and unreasonably disadvantages them. It is disruptive to employees' normal work activities to serve as impromptu escorts, and is not an efficient use of utility personnel. Persons with disabilities should have adequate access to SJWC offices to pay bills and conduct other business with the utility, but the

⁵² See § 451.

⁵³ See § 453.

⁵⁴ Government Code § 11135 states, in part:

(a) No person in the State of California shall, on the basis of race, national origin, ethnic group identification, religion, age, sex, sexual orientation, color, or disability, be unlawfully denied full and equal access to the benefits of, or be unlawfully subjected to discrimination under, any program or activity that is conducted, operated, or administered by the state or by any state agency, is funded directly by the state, or receives any financial assistance from the state...

(b) With respect to discrimination on the basis of disability, programs and activities subject to subdivision (a) shall meet the protections and prohibitions contained in Section 202 of the Americans with Disabilities Act of 1990 (42 U.S.C. Sec. 12132), and the federal rules and regulations adopted in implementation thereof, except that if the laws of this state prescribe stronger protections and prohibitions, the programs and activities subject to subdivision (a) shall be subject to the stronger protections and prohibitions.

(c) (1) As used in this section, "disability" means any mental or physical disability, as defined in Section 12926...

Main Office cannot be sufficiently remodeled to provide adequate access for persons with limited mobility.

We have previously taken actions to improve access for disabled persons. For example, D.07-03-044, finding the memorandum of understanding (MOU) between Pacific Gas and Electric Company (PG&E) and the Disability Rights Advocates to be reasonable and in the public interest, approved the MOU requiring PG&E to, among other things, maintain and improve access to its local offices and pay stations by disabled persons.

In adopting budgets, policies and program parameters for the Low Income Energy Efficiency and California Alternate Rate for Energy programs of PG&E, Southern California Edison Company, Southern California Gas Company (SoCalGas) and San Diego Gas & Electric Company (SDG&E) for 2007 and 2008, D.06-12-038 directed PG&E to develop a plan for working with local governments to establish Cool Centers and required that those Cool Centers be accessible to disabled customers.⁵⁵

Thus, we have encouraged or required those under our jurisdiction to comply with the ADA or take other measures to ensure reasonable access for the disabled,⁵⁶ and it is reasonable for SJWC to provide adequate access for physically disabled persons to its offices and customer service center.

Our recognition of the Main Office's inadequate access for the disabled is not intended to establish new standards for access to public utility facilities by disabled persons. Rather, we acknowledge here the importance of access for

⁵⁵ *Mimeo.*, p. 33.

⁵⁶ For example, D.92-12-065 requires all passenger stage and charter-party carriers to comply with the ADA.

disabled persons with respect to utilities' obligation, pursuant to § 451, to furnish and maintain adequate facilities necessary to promote the safety, health, comfort, and convenience of patrons, employees, and the public.

Security at the Main Office is inadequate. Because the rear entrance should remain locked for security purposes, requiring disabled persons to use the rear entrance undermines SJWC's ability to ensure the security of the facility. Other modern security improvements such as card reader access locks or separation between customer and employee areas will be difficult or impossible to make because of limitations on the kinds of modifications that can be made to the Main Office as a designated historic landmark.

As a result, the Main Office cannot be adequately modified to ensure the safety of SJWC's employees and customers. Requiring SJWC to provide access for the public at another existing SJWC facility will not enhance the security of employees who remain at the Main Office.

Finally, requiring SJWC to retain the Main Office will negatively affect operational efficiency. Requiring SJWC to implement the Base Case unreasonably constrains SJWC's ability to situate its staff, and adequate facilities are required to provide the flexibility to locate and physically arrange staff to achieve optimal operational efficiency.

We have previously authorized utilities to sell office facilities when those facilities were determined to be inadequate. For example, D.87-09-076 authorized SoCalGas to sell its headquarters property. In doing so, the Commission found that SoCalGas' headquarters facilities, although necessary and useful in the conduct of its public utility duties, were located in buildings which were considered antiquated, inefficient, costly to maintain and operate, and required earthquake modification and asbestos removal if continued in

use.⁵⁷ D.87-09-076 also found that, because of space shortages in its current headquarters facilities, SoCalGas had to house some staff functions and operations in detached outlying facilities, causing inefficiencies and poor communications.⁵⁸

Subsequently, in reviewing the reasonableness of SoCalGas' sale of the Flower Street headquarters buildings, D.90-04-028 found that SoCalGas' decision to move was reasonable because of the physical, functional, and technological obsolescence of the aging buildings and the unsuitability of the buildings for long-term use.⁵⁹

As noted above, A.04-08-017 considered Cal Water's application for authority to replace its operations center and customer center in the Chico District, but found that, except for wells and related equipment, those centers were no longer necessary or useful utility property and their sale did not require approval pursuant to § 851.⁶⁰ Cal Water's old Chico operations center was found to contain excessive mold and moisture due to water intrusion, and attempts to repair the leaks were unsuccessful. The building was also unable to accommodate all employees, requiring meetings to be held at alternate locations. Cal Water's old Chico customer center lacked adequate office space, and contained obsolete wiring.

Although SJWC's Main Office continues to be necessary and useful utility property, the Main Office is not an adequate or efficient facility because it cannot

⁵⁷ See D.87-09-076, FOF 2.

⁵⁸ See D.87-09-076, FOF 3.

⁵⁹ See D.90-04-028, as modified by D.90-11-031, FOF 11 (38 CPUC 2d, 200).

⁶⁰ See D.05-12-002.

be remodeled sufficiently to provide reasonable access for disabled persons, a secure and adequate work environment, or the flexibility to collocate departmental staff. Therefore, it is reasonable for SJWC to sell the Main Office.

DRA contends that the Main Office can be satisfactorily remodeled, that SJWC failed to prove the Main Office suffers from noise pollution, that the Base Case addresses all ADA requirements and security concerns, and provides the same operational flexibility as the alternatives.⁶¹ DRA's comments re-argue issues previously addressed, and inappropriately introduce evidence not in the record.⁶²

6. Reasonableness of the Selling Price for the Main Office

SJWC has entered into a Purchase and Sale Agreement with Adobe Systems, Inc. for the purchase of the Main Office for \$4 million.⁶³ To support its position that the sales price for the Main Office is reasonable, SJWC submitted two independent appraisals reflecting a fair market value for the property of between \$3.1 million and \$4.2 million.⁶⁴

An appraisal by Colliers International, dated February 28, 2006, appraises the value of the Main Office at \$3.1 million as of February 15, 2006. The Colliers International appraisal states that SJWC's parcel is adjacent to a parcel that is currently entitled for development of 1,000,000 ft² of office space. As part of this

⁶¹ Opening Comments of DRA on Proposed Decision of ALJ Smith, pp. 2-7.

⁶² See Opening Comments of DRA on Proposed Decision of ALJ Smith, pp. 3-5 in connection with footnotes 8-10, 14.

⁶³ Exh. SJWC-1, Yoo Attachment B.

⁶⁴ Exh. SJWC-1, Yoo Attachment C.

entitlement, the annex building and satellite building were scheduled for demolition and development as a common public park area due to setback issues from the Guadalupe River. Therefore, the appraisal only included the main building structure in its analysis because, according to Colliers International, the annex and satellite buildings would have no value to a buyer.

An appraisal by Hulberg & Associates, dated March 15, 2006, appraises the value of the Main Office at \$4.2 million as of March 1, 2006, and includes the structures excluded from the Colliers International appraisal. The Hulberg & Associates appraisal states that, although the rear portion of the site is of limited value to the typical buyer, it is possible that a higher price could be obtained if the property was sold to the developer of the adjacent 4.53-acre parcel and incorporated into a larger project.

Although DRA opposes the Proposed Transaction altogether because it contends that remodeling the Main Office and leasing additional space is less costly, DRA does not contend that the sale price for the Main Office is unreasonable.

Discussion

The \$4 million price for which SJWC has agreed to sell the Main Office is 5% less than the Hulberg & Associates appraisal. However, the Hulberg & Associates appraisal assumes value for structures that are scheduled for demolition. Therefore, the Hulberg & Associates appraisal likely overstates the actual price that can be reasonably obtained for the property.

The Hulberg & Associates appraisal states that a higher price may possibly be obtained by incorporating the property into a larger project, if the developer of the adjacent parcel was interested in purchasing the property. However, there is no evidence that the developer of the adjacent parcel ever expressed an

interest in purchasing the Main Office, and it is unlikely that the Main Office can be sold for the highest appraisal value. Therefore, the agreed upon selling price of \$4 million is reasonable.

7. Eligibility of the Net Proceeds from the Sale of the Main Office for Reinvestment Pursuant to § 790

The Application states that although SJWC continues to operate out of the facility, the Main Office has reached the end of its useful life. Thus, because SJWC believes its Main Office facility is no longer useful, it filed the Application, in part, to request that the Commission make the determination that the Main Office facility is no longer necessary or useful.⁶⁵ Alternatively, SJWC contends that, once the Commission concludes that SJWC can sell the property, the property becomes no longer necessary or useful and § 790 applies.⁶⁶

Discussion

As discussed above, the Application, Exhibits, Motion for Reconsideration and Brief on Legal Issues all conclusively confirm that the Main Office continues to be necessary and useful utility property, not only at the time of sale, but also for a period of time after the sale. SJWC seeks to sell property that is currently in rate base and generating a revenue requirement, is currently occupied and used to provide utility service, and will continue to be necessary and useful for providing utility service at, and after, the time of sale.

SJWC, itself, contends that the sale of the Main Office requires approval pursuant to § 851 because the property is still being used to provide utility

⁶⁵ Application, p. 9.

⁶⁶ Brief on Legal Issues, p. 2.

services. At the same time, SJWC asks the Commission to designate the property to be no longer necessary or useful, and to authorize to reinvest 100% of the net proceeds from the sale in utility infrastructure pursuant to § 790. SJWC cannot have it both ways.

SJWC's request that the Commission make the determination that the Main Office facility is no longer necessary or useful is not the usual procedure that SJWC follows when designating utility property as no longer necessary or useful. According to SJWC, when it determines that a particular piece of utility property is no longer necessary or useful, it prepares a memorandum explaining why the property is no longer necessary or useful and submits the memorandum to the Vice President of Operations who makes the final determination that the utility property is no longer necessary or useful.⁶⁷ Once SJWC determines that a piece of utility property is no longer necessary or useful, the property is transferred from utility plant in service to a non-operating account. There is no evidence that SJWC followed this procedure with respect to the Main Office. Instead, SJWC filed the Application, in part, to request that the Commission make the determination.

SJWC does not point to any decisions or other law to support its contention that, if the Commission authorizes SJWC to sell the property, the property becomes no longer necessary or useful, and § 790 applies. Commission approval to sell necessary or useful utility property does not change the need for, or the usefulness of, that property. In this instance, approval to sell the Main Office does not eliminate SJWC's need to house its corporate functions or to

⁶⁷ TR 232:20-233:8.

provide customers a walk in location to pay bills at that location until those functions are moved to the Replacement Facility.

Because SJWC will continue to use the Main Office for corporate functions and as a customer service center until and after it is sold, the Main Office continues to be necessary and useful even after SJWC receives authority to sell the facility. Commission approval only authorizes SJWC to sell the Main Office, but such approval does not render the Main Office unnecessary or useless.

As discussed above, the deficiencies of the Main Office make evident that it is inadequate for public utility service, but these deficiencies do not support a finding that the Main Office is no longer necessary or useful. Because the Proposed Transaction does not involve real property that is no longer necessary or useful, the proceeds from the sale of SJWC's Main Office are not eligible for reinvestment pursuant to § 790. Therefore, we deny SJWC's request for authorization to reinvest the net proceeds from the sale of its Main Office in infrastructure pursuant to § 790. This determination affirms the September 13 ACR.

The Gain on Sale Decision provides that utility ratepayers share in the gains or losses on the sale of water utility assets, except where the asset sold is real property that is no longer necessary or useful, in which case the proceeds shall be reinvested in accordance with § 790.⁶⁸ The Proposed Transaction involves the sale of real property that is necessary and useful, and, therefore, the net proceeds from the sale of the Main Office should be allocated to ratepayers and shareholders pursuant to the Gain on Sale Decision.

⁶⁸ D.06-05-041 (as modified by D.06-12-043), COL 24, OPs 1, 9, 20.

The net proceeds from the sale of the Main Office are determined by subtracting from the sale price the book value of land and improvements, commissions, escrow and title fees, and taxes.

Table 1	
Determination of the Net Proceeds from the Sale of the Main Office	
Main Office sale price	\$ 4,000,000
Less:	
Book value of land	\$ 30,318
Book value of structures and improvements (S&I)	\$ 1,242,957
Transaction costs/commissions (estimated)	\$ 137,200
Escrow/title fees (estimated)	\$ 15,360
Proceeds before taxes	\$ 2,574,165
Taxes @ 40.75% (estimated)	\$ 1,048,972
Net proceeds from the transaction	\$ 1,525,193
Source: SJWC-1, Jensen Tab, p. 3	

As shown in Table 1, the net proceeds from the sale of the Main Office are \$1,525,193. The Percentage Allocation Rule provides that utility ratepayers receive 100% of gains on sale of depreciable utility assets and 67% of gains or losses on sale of non-depreciable utility assets.⁶⁹ The utilities' shareholders receive the remaining 33% of gains or losses on sale of non-depreciable assets.⁷⁰

⁶⁹ D.06-05-041, OP 1, as modified by D.06-12-043.

⁷⁰ Depreciable assets include, but are not limited to, buildings, equipment, machinery, materials and vehicles, excluding routine retirements of minor utility assets that are no longer necessary or useful. Non-depreciable assets, but are not limited to, land, water rights and goodwill. D.06-05-041, OPs 2, 3 (as modified by D.06-12-043).

To determine ratepayers' share of the net proceeds from the sale of the Main Office we first determine the portion of the net proceeds attributable to gains on depreciable assets so that 100% of that amount can be allocated to ratepayers. We then determine the portion of the net proceeds attributable to gains on non-depreciable assets so that amount can be allocated 67% to ratepayers and 33% to shareholders. Table 2 shows how the gain from the sale of the Main Office should be allocated between ratepayers and shareholders.

If the net proceeds are apportioned according to book values, Table 2 shows that non-depreciable land accounts for 2.4% of the gain to be split "67/33" between ratepayers and shareholders, and depreciable structures and improvements account for 97.6% of the gain that should be allocated 100% to ratepayers.

Table 2			
Allocation of the Net Proceeds Between Ratepayers and Shareholders			
Depreciable/Non-depreciable Assets	Land	Structures and Improvements	Total
Asset Book Value ⁷¹	\$30,318	\$1,242,957	\$1,273,275
Book Value as Percent of Total	2.4%	97.6%	100.0%
Depreciable & Non-depreciable Gain (Net proceeds multiplied by book value percentage)	\$36,316	\$1,488,877	\$1,525,193
Percent of Gain Allocated to Ratepayers (from D.06-05-041, Ordering Paragraphs 1-3)	67%	100%	
Portion of Net Proceeds Allocated to Ratepayers	\$24,332	\$1,488,877	\$1,513,209
Portion of Net Proceeds Allocated to Shareholders	\$11,984	\$0	\$11,984
Total Net Proceeds	\$36,316	\$1,488,877	\$1,525,193

As shown in Table 2, the ratepayers' share of the gain on the sale of the Main Office is \$1,513,209. This is an average of \$7.03 per customer.⁷² The ratepayers' share of the gain should be distributed to SJWC's customers by applying a one-time surcredit, or a monthly surcredit to customer bills for a period not to exceed one year.

⁷¹ Exh. SJWC-1, Jensen, p. 3.

⁷² The per-customer share of the gain is derived by dividing the portion of net proceeds allocated to ratepayers (\$1,507,035) by the total number of customers shown on Exh. SJWC-1, Jensen Attachment C.

SJWC asserts that the PD's use of book value to determine the value of the net proceeds to be allocated to ratepayers and shareholders is unjustified, arbitrary, and unreasonable.⁷³ SJWC contends that the value of the non-depreciable assets (i.e., the land at the Main Office) should be based on market value, as estimated in the two appraisals submitted into the record by SJWC. SJWC asserts that valuating the land according to book value is illogical, and that the PD offers no justification for doing so. SJWC's asserts that this results in shareholders receiving a smaller share of the net proceeds than they would otherwise receive if the land was valued according to market value.

D.06-05-041, as modified by D.06-12-043, states, "a utility receives a gain on sale when it sells an asset such as land, buildings or other tangible or intangible assets at a price higher than the acquisition cost of the non-depreciable asset or the depreciated book value of the depreciable asset..."⁷⁴ For ratemaking purposes, the "book value" of land is the "acquisition cost" as used in D.06-05-041, as modified by D.06-12-043.

D.06-05-041, as modified by D.06-12-043, further states:

We reject an approach that allocates most (or all) of the gains on sale of land and other non-depreciable property to utility shareholders. The utilities' key argument in favor of a large shareholder allocation is that they only receive a rate of return on the original cost of land. Any appreciation in the value of the land, they claim, should therefore pass to shareholders.

The United States Supreme Court long ago held that ratemaking bodies need not give utility shareholders a rate of return based on the "present fair value" of utility property. *Federal Power*

⁷³ SJWC's Opening Comments on Proposed Decision of ALJ Smith, pp. 3-5.

⁷⁴ D.06-05-041 (as modified by D.06-12-043), p. 8. Emphasis added.

Commission v. Hope Natural Gas Company, 320 U.S. 591, 599-600 (1944).⁷⁵ The *Democratic Central Committee* court explained the *Hope Natural Gas* holding as making it “clear that the utility is not entitled of right to have its rate base established at the value which the assets would command on the current market, although that market value exceeds original cost.” *Democratic Central Committee*, 485 F.2d at 802.

D.06-05-041, as modified by D.06-12-043, requires gains to be allocated according to the percentage allocation default rule (100% depreciable and 67% - 33% non-depreciable) relating to gains on sale shall apply to water utility sale assets, except where the asset sold is real property that is no longer used and useful, and that the percentage allocation rule applies to routine asset sales where the sale price is \$50 million or less and the after-tax gain or loss from the sale is \$10 million or less⁷⁶. Neither of those circumstances apply to this case. Therefore, SJWC’s assertion that market value should be used to determine the net proceeds to be allocated to ratepayers and shareholders lacks merit.

8. Discounted Cash Flow (DCF) and Revenue Requirement Analyses of Alternatives

The Application presents three options that SJWC considered to address its need for adequate facilities, comparing the capital outlay and NPV (net present value) of each to show the process SJWC used to select Alternative 2.

The three options analyzed include the Base Case (renovating the Main Office), Alternative 1 (sell the Main Office, relocate to a newly leased office and to existing facilities on South Bascom Avenue, and renovate and additional space at 1265 South Bascom Avenue), and Alternative 2 (identical to Alternative 1,

⁷⁵ *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 599-600 (1944).

⁷⁶ OP 4 and 20.

except that a new office in downtown San Jose will be purchased instead of leased, and 1265 South Bascom Avenue will be purchased instead of leased).

DRA contends that SJWC's DCF and revenue requirement analyses of these alternatives are flawed because:

1. The analyses fail to include cash flows from revenues collected from ratepayers, and the analyses compute the revenue requirement for each alternative for the first year rate increase only but should compute the NPV of revenue requirements over the life of each alternative;
2. The DCF analysis of Alternative 2 inappropriately assumes that shareholders will get the proceeds from the sale of the Replacement Facility at the end of its useful life, thereby understating the actual cost of Alternative 2;
3. The DCF analysis of Alternative 2 should be based on the \$6.7 million purchase price of the Replacement Facility and not the portion of the purchase price (\$3.795 million) that SJWC seeks to recover in this Application;
4. The DCF analysis of Alternative 2 should not include income that SJWC assumes it will receive from leasing excess space in the Replacement Facility that will not be dedicated to public utility service;
5. The revenue requirement analysis applies the incorrect net-to-gross (NTG) multiplier, thereby artificially increasing the requested revenue requirement;
6. The revenue requirement analysis should calculate depreciation based on gross plant but erroneously calculates depreciation based on net plant;
7. The DCF analysis of Alternative 2 fails to escalate the lease payments for a new downtown Main Office building and 1265 South Bascom Avenue building after the 10th year;
8. The analyses fail to reflect the deferral of taxes allowed under the Internal Revenue Code resulting from the exchange of property.

8.1. Computation of the NPV of Revenue Requirements for each Alternative

DRA states that the DCF analyses of the alternatives are flawed because they fail to include cash flows from revenues collected from ratepayers.⁷⁷ DRA contends that the failure to consider the revenues collected from ratepayers for each alternative during the life of the project invalidates the DCF analyses.

DRA also states that SJWC should have compared the NPV of revenue requirements for each scenario over the life of the project, then select the alternative resulting in the lowest revenue requirement. Instead, according to DRA, SJWC inappropriately computed the revenue requirements for the first year rate increase only.

SJWC responds that its DCF analysis is intended to evaluate the financial feasibility of each option, and, therefore, is limited to the capital costs, one-time costs, and recurring costs associated with the three options.⁷⁸ According to SJWC, although revenues from ratepayers were excluded from the DCF analyses, they were included in the revenue requirement calculations for Alternative 2. SJWC states that the DCF, not revenue requirement, analysis is the proper and accepted method to evaluate the financial feasibility of each option.⁷⁹ Therefore, SJWC contends, its DCF analyses are appropriate.

⁷⁷ Exh. DRA-1, p. 13. DRA Opening Brief, p. 6.

⁷⁸ Exh. SJWC-4, p. 3.

⁷⁹ SJWC Opening Brief, p. 13.

Discussion

The Application was filed, in part, for Commission approval to impose the costs of this project on SJWC's ratepayers through an increase in SJWC's revenue requirement. The DCF analyses should, therefore, include the effects on ratepayers of each option during the life of the project so that a meaningful comparison can be made of the cost to ratepayers of the different options.

Specifically, the DCF analyses should include the costs to ratepayers for the return on capital investments paid to SJWC's shareholders. Excluding these costs from the DCF analyses artificially understates the true costs of the different options, each of which includes capital investments and returns on those investments, which will ultimately be paid by SJWC's ratepayers.

Although the Base Case and Alternative 1 include capital costs, the lion's share of capital costs are in Alternative 2 for the purchase of the Replacement Facility and the purchase of 1265 South Bascom Avenue. For example, SJWC asserts that the capital outlay of the Base Case, Alternative 1 and Alternative 2 are \$4,757,325, \$575,745, and \$9,121,591, respectively.⁸⁰ Thus, even according to SJWC's analyses, the capital cost of Alternative 2 is almost double that of the Base Case and almost sixteen times that of Alternative 1.

Omitting return on investment costs from the DCF analyses understates the true NPV of all of the options, but this omission disproportionately understates the NPV of Alternative 2 because of the larger capital costs associated with the purchases of the Replacement Facility and 1265 South Bascom Avenue.

⁸⁰ Exh. SJWC-1, Stein, p. 8.

Excluding return on investment costs from the DCF analyses contributes significantly to making Alternative 2 appear to be the lower-cost option. Hence, Alternative 2 became the preferred, and only, option for which SJWC computed a revenue requirement,⁸¹ where the cost of capital is then accounted for. This inappropriately removes Alternative 1 from consideration as a low cost option for which a revenue requirement should be computed.

Therefore, the DCF analyses should be revised for Alternative 1 and Alternative 2 to include the costs of to ratepayers, including return on investment costs paid to SJWC's shareholders for the capital associated with each of those options. As discussed above, we have determined that the Main Office cannot be sufficiently renovated to provide adequate facilities. Therefore, it is unnecessary to estimate the costs for the Base Case because it is unreasonable to implement an option that does not provide adequate facilities.

8.2. Proceeds from the Eventual Sale of Facilities

DRA states that SJWC's DCF analysis of Alternative 2 inappropriately assumes that shareholders will get 100% of the proceeds from the sale of the Replacement Facility at the end of 35 years.⁸² DRA contends that, when revised to remove this assumption, the Base Case is the least cost option.

SJWC responds that its analysis assumes at the end of the useful life of the Replacement Facility, the building will be abandoned, declared no longer necessary and useful for utility purposes, and then sold. SJWC asserts that any net proceeds from this future transaction could then be reinvested in utility plant

⁸¹ TR 219:25 - 220:8.

⁸² DRA Opening Brief, pp. 6-7.

to the benefit of all SJWC's customers. SJWC contends that inclusion of this assumption is consistent with § 790 and the September 13 ACR.⁸³

Discussion

The DCF analysis for Alternative 2 should not include \$14.98 million in estimated proceeds from the future sale of the Replacement Facility, which the analysis assumes will accrue 100% to shareholders.⁸⁴ In the same way this Application considers SJWC's request to sell the Main Office, the scenario the SJWC assumes in its analysis concerning the future disposition of the Replacement Facility should be considered in a future application for authority to sell that facility and to reinvest the net proceeds from that sale in utility property.

The inappropriateness of including estimated proceeds from the eventual sale of the Replacement Property is apparent because, although SJWC asserts that any net proceeds from the future sale of the Replacement Facility can be reinvested in utility plant, the DCF analysis does not include any costs related to replacing the Replacement Facility. Thus, by including estimated proceeds from the sale of the Replacement Property, but not the costs of replacing that facility, SJWC implicitly assumes that it will either replace the Replacement Facility at no cost, or that the Replacement Facility will not be replaced at all. Neither of these implicit assumptions is reasonable. If there are going to be proceeds from the sale of the Replacement Facility, there are also going to be costs associated with replacing that facility after it has been sold.

⁸³ Exh. SJWC-5, p. 3.

⁸⁴ See Exh. SJWC-1, Stein Exhibit 12, p. 36.

Consideration of any proceeds from the sale of the Replacement Facility belongs in the “next iteration,” when SJWC files an application for approval to sell the Replacement Facility and to reinvest the proceeds from the sale in utility property. At that time, the Commission will be able to consider, among other things, the need and usefulness of the Replacement Facility, whether the estimated sales price is reasonable, whether the proceeds from that future sale will be eligible for reinvestment in utility property, and the reasonableness of the costs associated with replacing the Replacement Facility.

The Application does not seek approval to sell the Replacement Facility or to reinvest the proceeds from the sale of that facility in utility property. It is, therefore, beyond the scope of this proceeding to make assumptions about the need and usefulness of the Replacement Facility 35 years from now (or whenever SJWC determines that it should sell the Replacement Facility), the reasonableness of the estimated sales price, or whether the disposition of the proceeds from that future sale should be reinvested in utility property or distributed to ratepayers and shareholders. Including estimated proceeds from the future sale of the Replacement Facility in the DCF analysis of Alternative 2 assumes that the Commission will rule favorably to SJWC on all of these issues.

If, and when, SJWC seeks to dispose of the Replacement Facility, issues concerning the value and disposition of proceeds from the sale of that facility will be considered, based on the facts extant when the request comes before the Commission. Only then should a cost analysis consider the economic effects related to the disposition of the Replacement Facility. Therefore, estimated revenues from the sale of the Replacement Facility should not be included in the DCF analysis related to this Application.

Although DRA did not raise the same concern with respect to the future sale of 1265 South Bascom Avenue, the DCF analysis for Alternative 2 includes an estimated \$16.97 million in proceeds from the sale of 1265 South Bascom Avenue at the end of 35 years, which SJWC also assumes will be credited 100% to shareholders.⁸⁵ For the same reasons that we will not include estimated revenues from the sale of the Replacement Facility in the DCF analysis, estimated revenues from the future sale of 1265 South Bascom Avenue will not be included in the DCF analysis of Alternative 2.

8.3. Purchase Price of the Replacement Facility

The DCF analysis assumes a \$3.795 million cost for a new Main Office. However, because SJWC subsequently informed the Commission that it will pay \$6.7 million for the Replacement Facility, DRA asserts that the DCF analysis should be based on the total purchase price of \$6.7 million. DRA contends that SJWC will soon seek authority to recover the remainder of the purchase price. Therefore, according to DRA, the Commission should assume that SJWC is seeking recovery of the full purchase price now. DRA contends that a DCF analysis that assumes a \$6.7 million purchase price for the Replacement Facility results in the Base Case being the most cost effective alternative.

SJWC responds that its request for \$3.795 million for cost of the Replacement Facility is not altered or changed, even though it paid \$6.7 million for the Replacement Facility, and it would be inappropriate to include a \$6.7 million cost for the Replacement Facility in the DCF analysis.

⁸⁵ See Exh. SJWC-1, Stein Exhibit 10B, p. 30.

Discussion

DRA's recommendation that the Commission assume a purchase price of \$6.7 million for the Replacement Facility is inappropriate because SJWC is not seeking recovery of the full purchase price of the Replacement Facility in this Application. The Commission should not consider recovery of the full purchase price now, in anticipation of a yet-to-be-filed application. The Scoping Memo limits our consideration to the requested rate increase and to the proposed rate design for recovering the increased costs resulting from approval of the Application.

The Commission has before it SJWC's request to recover \$3.795 million of the purchase price for the Replacement Facility, and that is the cost for the purchase of a Main Office replacement facility that will be considered in this proceeding. Issues concerning the recovery of any remaining cost of the Replacement Facility will be addressed if, and when, SJWC seeks to include those costs in rate base and to recover the costs from ratepayers. Therefore, we reject DRA's recommendation for the Commission to assume a purchase price of \$6.7 million for a new office facility.

8.4. Income from Leasing Excess Space in the Replacement Facility

SJWC states that, in May 2007, it updated its DCF analysis for Alternative 2 to revise assumptions concerning downtown office rents and rents for temporary office space to reflect current market conditions, and to reflect the anticipated purchase price of the Replacement Facility.⁸⁶ The revised analysis assumes that a portion of the Replacement Facility will not be needed in the

⁸⁶ Exh. SJWC-4, pp. 1-2.

short term and can be leased to a third party. As a result, SJWC includes rental income it estimates it will receive from leasing excess space in the Replacement Facility.

SJWC states that the Replacement Facility contains 12,000 ft.² more than the Base Case and Alternative 1, against which it was being compared. In order to make the three options comparable, SJWC's revised analysis assumes the excess space would be leased, and treats the lease income as an offset to the purchase price of the Replacement Facility.⁸⁷ According to SJWC, DRA requested SJWC to remove from the revised analysis the rental income derived from the excess space, but doing this makes a side-by-side comparison of the alternatives inappropriate.

SJWC contends that excluding the income from leasing the excess space makes comparisons among the alternatives misleading because the total floor space in Alternative 2 is larger than the other options, and, according to SJWC, this inappropriately increases the total cost of Alternative 2. SJWC contends, however, that on a per square foot basis, Alternative 2 continues to be the least cost option.

Discussion

The DCF analysis for Alternative 2 should not include income that SJWC assumes it will receive from leasing the excess space in the Replacement Facility because SJWC is not dedicating that additional space to public utility service nor seeking recovery of the cost for that excess space in utility rates. As discussed above, because we do not assume in the DCF analysis of Alternative 2 the full

⁸⁷ TR 198:8 - 199:19.

purchase price of \$6.7 million for the entire Replacement Facility (including the excess space), it is also appropriate to exclude from the DCF analysis income from leasing the excess space in the Replacement Facility that will not be dedicated to public utility service.

8.5. Net-to-Gross (NTG) Multiplier

DRA states that SJWC applied the incorrect NTG multiplier, thereby inappropriately increasing the estimated revenue requirement for Alternative 2. DRA contends that SJWC's NTG multiplier is applicable only to changes in expense or changes in the overall rate of return but not to changes in rate base.⁸⁸ After accounting for the tax deductibility of interest expenses, DRA contends that the correct NTG multiplier is 1.4173. According to DRA, this is because rate base increases for SJWC are funded through approximately 47.53% debt and 52.47% equity, and the interest payments on debt are tax deductible.

SJWC responds that the NTG multiplier of 1.6955 was adopted in D.06-11-015 in SJWC's most recent GRC, and complies with Commission directives contained in the Water Division Memorandum "Net-to-Gross Multiplier Calculation and Summary of Earnings Comparison", dated May 4, 1990, and with SP U-3-SM.⁸⁹

Discussion

The NTG multiplier is a factor that is used in the ratemaking process to determine the unit change in gross revenues required to produce a unit change in net revenues, to calculate the additional revenue required to pay taxes, to

⁸⁸ TR 375:2-9. DRA Opening Brief, pp. 7-9.

⁸⁹ Exh. SJWC-5, pp. 1-2.

consider the effect of uncollectibles, and to achieve a given revenue requirement after taxes. The NTG multiplier is determined by taking the reciprocal of one minus the sum of the uncollectibles rate, franchise tax rate, and state and federal income tax rates. It depends largely on the tax rates applicable to the cost components included in the analysis. The value of the NTG multiplier will be different if the costs analyzed include capital costs, which are taxed at a different rate than other cost components.

After reasonable expenses and depreciation are determined, the return on investment is calculated by multiplying the rate of return by the rate base. The revenue requirement can then be determined by multiplying the dollar return by the NTG multiplier, and adding expenses and depreciation to that result. To determine the revenue requirement for a particular scenario, the appropriate NTG multiplier must be applied to the NPV costs for that scenario.

Because the tax effect on debt is different from that for equity, the NTG multipliers for each are different. The replacement of the Main Office requires a combination of debt and equity capital costs that are taxed at different rates, and the NTG multiplier for each of these components must be weighted according to SJWC's authorized capital structure to determine the appropriate rate base NTG multiplier. SJWC's NTG multiplier does not do this.

The NTG multiplier authorized in D.06-11-015 is appropriate only for determining the revenue requirement resulting from changes in the return on equity or changes in the overall rate of return. Without adjustment, this NTG multiplier will overstate the effect of taxes resulting from the purchase of the Replacement Facility because it does not account for the tax deductibility of debt interest. Because we don't know the exact amount of debt and equity used to finance the purchase of the Replacement Facility, we assume that this capital

expenditure is spread in the same ratio as SJWC's authorized capital structure (47.53% long-term debt and 52.47% common equity).

SJWC's reliance on the Water Division Memorandum "Net-to-Gross Multiplier Calculation and Summary of earnings Comparison", dated May 4, 1990 (1990 Water Division Memorandum) is misplaced. The 1990 Water Division Memorandum applies to changes in expense, but does not address changes capital costs.⁹⁰ An NTG multiplier based on the 1990 Water Division Memorandum will overstate the effect of taxes resulting from the purchase of a new Main Office because it does not account for the tax deductibility of debt interest.

SJWC's reliance on SP U-3-SM is also misplaced. SP U-3-SM applies to small (Class B, C, and D) water utilities, and provides guidance to Commission staff preparing Staff Reports comprising the Results of Operation for Class B, C and D water company or sewer company GRCs.⁹¹ The provisions of SP U-3-SM are applicable to Class A water utilities such as SJWC only when specifically authorized by the Commission.⁹² SJWC has not been authorized to apply the provisions of SP U-3-SM, so SP U-3-SM does not apply to this Application.

Because no taxes are paid on the interest applied to debt, the NTG multiplier applied to the weighted cost of long-term debt is lower than that applied to the weighted cost of common equity. Only the uncollectible rate and

⁹⁰ See Exh. SJWC-8, Net-to-Gross Multiplier Calculation (p. 2), and Example - Calculation of Net-to-Gross Multiplier (p. 4).

⁹¹ SP U-3-SM, Section A.1, p. 1.

⁹² For example, Res. W-4556 authorized Great Oaks Water Company (Great Oaks) to file its GRC by advice letter pursuant to U-3-SM as an experiment. Other Class A water companies must seek a waiver for similar authority. (Res. W-4556, p. 6.)

franchise taxes are included in the long-term debt NTG multiplier. Because taxes are paid on the return on common equity, the NTG multiplier applied to that component includes both state and federal income taxes as well as the uncollectible rate and franchise taxes. This rate base NTG multiplier is then applied to the rate base increase, and the result is multiplied by the authorized rate of return to determine the effect on gross revenues resulting from the additional costs.

To determine the appropriate rate base NTG multiplier, the grossed up weighted cost of capital is divided by the weighted cost of capital. As shown in Table 3, this results in a rate base NTG multiplier of 1.4173.

Table 3					
Computation of Rate Base NTG Multiplier					
Description	Capital Ratio	Cost	Weighted Cost	Net to Gross	Gross Weighted Cost
Long-Term Debt	47.53%	7.54%	3.58%	1.00466	3.60%
Common Equity	52.47%	10.13%	5.32%	1.69550	9.01%
Total	100.00%		8.90%		12.61%
Rate Base Change Net to Gross = 12.61%/8.90%					1.4173
Source: D.06-11-015, Attachment B (Joint Comparison Exhibit), Section J (Return on Equity and Return on Rate Base), p. 9.					

Therefore, 1.4173 is the NTG multiplier that should be used to calculate the revenue requirement resulting from the replacement of the Main Office.

8.6. Calculating Depreciation on Plant

DRA contends that SJWC erroneously calculated depreciation on net plant when depreciation should have instead been based on gross plant.⁹³ SWJC agrees that depreciation should be based on gross plant.⁹⁴

Discussion

Depreciation expense should be based on gross plant. Applying depreciation to the gross plant in the Exhibit SJWC-1 analysis results in depreciation expense of \$57,302 for Alternative 1 and \$270,948 for Alternative 2.⁹⁵

8.7. Escalation of Lease Payments

DRA contends that SJWC's DCF analysis of Alternative 1 fails to escalate the payments to account for inflation for leasing a new downtown Main Office building and the 1265 South Bascom Avenue building after the 10th year.⁹⁶ DRA asserts that SJWC admitted this error during hearings. DRA recommends that the Commission reject SJWC's analysis because of this error and other flaws in the DCF analyses.

SJWC states that it inadvertently failed to escalate the payments for leasing a new downtown Main Office building and the 1265 South Bascom Avenue building after the 10th year in its original spreadsheet model.⁹⁷

⁹³ DRA Opening Brief, p. 9.

⁹⁴ TR 247:19-24.

⁹⁵ SJWC April 15, 2008 Response to ALJ Rulings, SJWC Rate Impact 10 Scenarios, Scenario 9 Alternative 2 Tab, Cell F51.

⁹⁶ DRA Opening Brief, p. 10.

⁹⁷ TR 246:10-11; 248:10-15.

Discussion

The DCF analyses presented in Exhibit SJWC-1 assumes lease costs under the Base Case and Alternative 1 will increase 3% per year for all years analyzed, except that rental costs for 1265 South Bascom Avenue will increase 3.5% per year during the first four years.⁹⁸ Because Alternative 2 assumes the purchase of a new office and 1265 South Bascom Avenue, lease costs do not apply to that alternative.

DRA includes in its testimony what it describes as a corrected SJWC DCF analysis.⁹⁹ DRA also submitted into evidence DRA-10, SJWC's response to DRA Data Request RK-2 containing spreadsheets responsive to DRA's request for, among other things, the escalation of the lease payments.¹⁰⁰

A review of DRA-1 and DRA-10 shows that the DCF analysis for the Base Case does not include any lease costs for 1265 South Bascom Avenue. This omission makes the Base Case appear less costly than it actually is. However, we have already determined above that the Base Case is not a reasonable option, so the omission is inconsequential.

A review of Alternative 1 in SJWC-1, DRA-1, and DRA-10 shows that they all escalate lease payments at 3% per year, except that rental costs for 1265 South Bascom Avenue increase 3.5% per year during the first four years.¹⁰¹ Thus, there is no error in the analysis of Alternative 1 for escalating lease payments for the

⁹⁸ Exh. SJWC-1, Stein Exhibit 2, pp. 3, 4, 16. Stein Exhibits 6 and 7, pp. 13-18. Exh. SJWC-1, Stein Exhibit 10A, pp. 25-27. Exh. SJWC-1, Stein Exhibit 11, pp. 31-33.

⁹⁹ Exh. DRA-1, Attachment A.

¹⁰⁰ Exh. DRA-10, Attachment E.

¹⁰¹ Exh. DRA-1, and Exh. DRA-10 do not include lease payments for the Base Case.

Replacement Facility and the 1265 South Bascom Avenue building after the 10th year. DRA's allegation that the analysis of Alternative 1 failed to escalate lease payments lacks merit.

DRA asserts the PD errs in finding that DRA's allegation that the analysis of Alternative 1 failed to escalate lease payments lacks merit because, according to DRA, the error it alleges is contained in SJWC's response to DRA data request RK-1. DRA states that the response was corrected by SJWC in subsequent responses.

The error that DRA alleges SJWC made is in SJWC's response to DRA data request RK-1, which is not part of the record. The alleged error is not reflected in any pleading or exhibit that SJWC has submitted into the record of this proceeding. Therefore, the PD correctly finds that DRA's allegation lacks merit.

We note, however, that although the analysis of Alternative 1 escalates estimated parking fees in year 2, it fails to escalate estimated parking fees after year 2.¹⁰² Therefore, the DCF analysis of Alternative 1 should be revised to escalate estimated parking fees for all years at 3% per year.

We also note that the analysis of Alternative 1 does not include operations and maintenance (O&M) costs for Year 1 and incorrectly escalates O&M costs in subsequent years. However, because O&M costs for SJWC's office facilities are already included in its current revenue requirement, it is appropriate to exclude these costs from the analyses. Therefore, the DCF analysis of Alternative 1 should be revised to exclude O&M costs.

¹⁰² Exh. SJWC-1, Stein, pp. 31-33.

8.8. Deferral of Taxes

The Internal Revenue Code provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.¹⁰³ This Internal Revenue Code provision is referred to as a “Section 1031 property exchange,” and requires a property exchange be completed not more than 180 days after transfer of exchanged property.

DRA states that SJWC erred by failing to reflect in the proposed revenue requirement analysis the deferral of taxes allowed for a Section 1031 property exchange when replacing the Main Office with a new office.¹⁰⁴ DRA contends that deferred capital gains tax resulting from a Section 1031 property exchange should be deducted from rate base.

SJWC states that the omission from its analysis of the deferred taxes resulting from a Section 1031 property exchange is not an error but is instead a difference in assumptions as to when the close of the purchase of the new facility would occur.¹⁰⁵ SJWC states that its purchase of the Replacement Facility closed on November 14, 2007, and if the sale of the Main Office is authorized by the Commission and closed by May 14, 2008 (i.e., within 180 days of the close of the

¹⁰³ Internal Revenue Code Title 26, Subtitle A, Chapter 1, Subchapter O, Part III, § 1031 (Exchange of property held for productive use or investment).

¹⁰⁴ DRA Opening Brief, pp. 9-10.

¹⁰⁵ TR 244:11-246:4.

purchase of the new facility), the transaction can be treated as a Section 1031 property exchange.¹⁰⁶

Discussion

The Internal Revenue Code requires that a Section 1031 property exchange be completed not more than 180 days after transfer of exchanged property. Because SJWC closed its purchase of the Replacement Facility (110 Taylor Street, San Jose) on November 14, 2007, the sale of the Main Office must be authorized by the Commission and closed by May 14, 2008, a date that has already passed, in order to be treated as a Section 1031 property exchange. Thus, the purchase of the Replacement Facility is not eligible for tax deferral under Internal Revenue Code Section 1031, and, therefore, the revenue requirement analysis for Alternative 2 should not reflect the deferral of taxes allowed under the Internal Revenue Code.

8.9. Summary of Revisions to the DCF Analyses and Resulting Revenue Requirements

As discussed above, the revenue effects on ratepayers should be included in the DCF analyses of Alternatives 1 and 2 to reflect the true costs to ratepayers so that the NPVs and revenue requirements for these alternatives may be compared on an “apples-to-apples” basis.¹⁰⁷ In particular, the DCF analysis should include return on investment costs paid to SJWC’s shareholders by

¹⁰⁶ Exh. SJWC-5, p. 4. TR 245:19-246:4.

¹⁰⁷ Although Alternative 1 includes capital costs for improvements to SJWC facilities located at 1221, 1251 and 1265 South Bascom Avenue, the capital costs and the returns on the investment for the purchase of the Replacement Facility and the purchase of 1265 South Bascom Avenue are not present in Alternative 1, which assumes that facilities will be leased.

SJWC's ratepayers because excluding these costs related to the purchases of the Replacement Facility and 1265 South Bascom Avenue understates the actual costs of the different options, and particularly Alternative 2.

The estimated proceeds from the future sale of the Replacement Facility and 1265 South Bascom Avenue should not be included in DCF analysis of Alternative 2 because the reasonableness of the assumed sale prices, or the eligibility of the sales proceeds for reinvestment in utility property are beyond the scope of this proceeding.

The DCF analysis of Alternative 2 should not include the full \$6.7 million purchase price for the Replacement Facility because it is not requested in the Application, and it is beyond the scope of this proceeding to anticipate a future application that SJWC may file to seek recovery of the remainder of the purchase price, or to consider in this proceeding issues appropriate for that yet-to-be-filed application.

The DCF analysis of Alternative 2 should not include income derived from leasing excess space in the Replacement Facility because that excess space is not property necessary or useful in the performance of SJWC's duties to the public and will not be included in rate base.

The DCF analyses should use 1.4173 as the NTG multiplier, and calculate depreciation expenses based on gross plant.

Although we have determined that the DCF analysis of Alternative 1 appropriately escalates lease payments for a new downtown Main Office building and 1265 South Bascom Avenue building after the 10th year, the analysis of Alternative 1 does not escalate costs for parking after Year 2. Therefore, the DCF analysis of Alternative 1 should be revised to escalate

estimated parking fees at 3% per year for all years analyzed. The DCF analysis of Alternative 1 should also be revised to exclude O&M costs.

The analyses of Alternative 2 should not be revised to reflect the deferral of taxes allowed under the Internal Revenue Code because the purchase of the Replacement Facility is not eligible for tax deferral.

The revised DCF analyses show that leasing facilities under Alternative 1 is less expensive than purchasing them under Alternative 2 (NPV of \$25,598,558 versus \$32,674,284), and the revenue requirement for Alternative 1 is \$1,133,520, while the revenue requirement for Alternative 2 is \$1,477,800 (a revenue increase of 0.61%). Appendix A compares the capital outlay and NPV for the alternatives, and Appendices B and C summarize the revised DCF and revenue requirement analyses.

DRA states that the calculations in Appendix A of the PD of the NPVs for Alternatives 1 and 2 are incorrect.¹⁰⁸ DRA asserts that the correct NPV for Alternative 1 is \$12,530,954 and for Alternative 2 is \$13,802,759. DRA recommends that changes be made to the PD pursuant to spreadsheets included as Attachment A to its comments. However, DRA does not explain why the PD's computation of the NPVs for Alternatives 1 and 2 are in error or why DRA's calculations are correct, and the spreadsheets in Attachment A to DRA's comments are insufficient to determine the correctness of DRA's computations.

¹⁰⁸ Opening Comments of DRA on Proposed Decision of ALJ Smith, p. 9.

9. Selection of Alternatives

SJWC asserts that its analysis shows the cost of Alternative 2 is lower than either Alternative 1 or the Base Case.¹⁰⁹ SJWC also contends that purchasing facilities under Alternative 2 is preferable to leasing facilities because SJWC will own the asset at the end of the term.

DRA contends that, based on its DCF analysis, the Base Case (remodeling the Main Office and leasing additional space at 1265 South Bascom Avenue) is the least cost option and is in the best interests of ratepayers.¹¹⁰ DRA also contends that the proposal to purchase the building at 1265 South Bascom Avenue under Alternative 2 is more costly than leasing additional space at that location.

Discussion

As discussed above, implementing the Base Case will not result in adequate facilities. An alternative that may cost less but which results in inadequate, inefficient facilities is not in the best interests of ratepayers and should not be implemented. Only Alternatives 1 and 2 are reasonable options because either will provide adequate facilities. However, Alternative 1 results in a lower revenue requirement.

Although SJWC requests an increase in the revenue requirement for 2007, the Proposed Transaction and replacement of the Main Office will not be completed before late 2008 at the earliest.

¹⁰⁹ Exh. SJWC-1, Stein - p. 3.

¹¹⁰ DRA Opening Brief, pp. 1,-2, 5, 10-11.

We recognize that SJWC has already purchased the Replacement Facility and 1265 South Bascom Avenue. As discussed below, SJWC does not need Commission approval to purchase property. However, if SJWC chooses to purchase property for public utility use before the Commission approves recovery of the costs in connection with the purchase, it does so at its own risk. In this case, we find that the cost of leasing replacement facilities is less than the cost of purchasing them. Approving the lower revenue requirement for comparable alternatives is in the best interests of ratepayers.

SJWC requests that it be authorized to include in its rate base \$3.795 million of the purchase of 110 West Taylor Street and \$4.3 million for the purchase of 1265 South Bascom Avenue. SJWC's request is untimely because the Application does not request that it be authorized to include any capital costs in rate base, and SJWC's first request for this authority is made in its comments on the PD.

The Scoping memo states that the proceeding will not decide whether SJWC may buy or lease facilities, but only whether costs associated with the transaction should be included in rate base or rates.¹¹¹ Because the PD authorizes a revenue requirement that is based on the cost of leasing (not purchasing) facilities, a decision on whether SJWC should be authorized to include in rate base some or all of the costs for the purchase of 110 West Taylor Street or the purchase of 1265 South Bascom Avenue should be deferred to SJWC's next GRC.

¹¹¹ Scoping Memo, Footnote 4, p. 4.

However, we will authorize SJWC to establish a memorandum account to track interim depreciation and other expenses, such as taxes, for retroactive recovery.

10. Rate Design for Recovering Increased Costs

SJWC seeks to recover 50% of the revenue requirement through the service charge component and the remaining 50% through the quantity rate component of its tariffed rates. DRA concurs with the rate design, stating that the proposed rate design is consistent with the Commission policy adopted in D.86-05-064.¹¹²

Discussion

We approve SJWC's proposal to recover 50% of the revenue requirement through the service charge component and the remaining 50% through the

¹¹² Exh. DRA-1, pp. 8-9.

quantity rate component of its tariffed rates because it is reasonable and consistent with Commission policy.

11. Other Issues

DRA alleges SJWC is paying San Jose Water Land Company (SJWLC), its affiliate, unreasonably high prices to rent space at the 1265 South Bascom Avenue facility in San Jose, and recommends that the Commission order SJWC to re-negotiate its lease at rates comparable to market rates. DRA also alleges that SJWC transferred five properties to SJWLC without Commission authorization. According to DRA, if the properties had been sold to third parties the proceeds from those sales could have been used to reduce future revenue requirements and rates charged to consumers. Finally, DRA contends SJWC purchased 1265 South Bascom Avenue before receiving permission to do so, and failed to inform the Commission that it had purchased 1265 South Bascom Avenue in violation of Rule 1.1.¹¹³

11.1. Alleged Excessive Lease Payments to Affiliate

DRA asserts that SJWC is paying its affiliate, SJWLC, nearly three times the market rate to rent space at the 1265 South Bascom Avenue facility.¹¹⁴ DRA contends that SJWC pays SJWLC \$35.44 per ft.²/year for space at 1265 South Bascom Avenue, while the market rate for similar office space is \$13.20 per

¹¹³ Rule 1.1 states: Any person who signs a pleading or brief, enters an appearance, offers testimony at a hearing, or transacts business with the Commission, by such act represents that he or she is authorized to do so and agrees to comply with the laws of this State; to maintain the respect due to the Commission, members of the Commission and its Administrative Law Judges; and never to mislead the Commission or its staff by an artifice or false statement of fact or law.

ft.²/year. DRA contends SJWC's lease payments to SJWLC for the 1265 South Bascom Avenue facility are relevant to this proceeding because, if SJWC renegotiated the lease it would pay a significantly lower rate, and lower lease payments would have a direct impact on rates.¹¹⁵ DRA states that a provision in the lease gives SJWC the right to renegotiate the lease, and DRA recommends that SJWC be required to renegotiate its lease with SJWLC.

SJWC responds that it was authorized to recover the cost of leasing the space on the second floor of 1265 South Bascom Avenue in its current revenue requirement, and this cost was also approved for recovery in SJWC's prior rate case. Therefore, according to SJWC, it is not appropriate to raise in this proceeding issues concerning lease payments for 1265 South Bascom Avenue.¹¹⁶

Discussion

D.06-11-015 approved a settlement between SJWC and DRA on SJWC's most recent GRC, and the lease payments to SJWLC for the 1265 South Bascom Avenue facility were approved as part of the settlement. SJWC's lease payments to SJWLC for the 1265 South Bascom Avenue facility are not relevant to this proceeding because SJWC does not seek approval of those expenses in this Application.

¹¹⁴ Exh. DRA-1, pp. 15-16. DRA Opening Brief, p. 19.

¹¹⁵ TR 9:4-28.

¹¹⁶ TR 5:10-6:7.

11.2. Alleged Unauthorized Property Transfers

DRA states that SJWC transferred five properties to its affiliates without required Commission approval.¹¹⁷ DRA contends that one or more of which DRA asserts could have been used as SJWC's Main Office. DRA states that the acquisition cost of the five properties transferred to SJWLC without Commission authorization was \$91,000 while the current estimated market value is \$15.96 million. DRA also contends that, if the properties had been sold to third parties, the proceeds could have been used to reduce future revenue requirements and rates charged to consumers.

DRA asserts that the properties transferred to SJWC's affiliates were included in rate base until the date of transfer and that ratepayers paid the authorized rate of return, maintenance expenses and taxes for the properties, but that ratepayers derived no benefits from the transfers. DRA recommends that SJWC be required to file applications pursuant to § 851 for the properties that it alleges SJWC transferred to SJWLC without authorization.

SJWC responds that the five properties which DRA alleges were improperly transferred to SJWLC without Commission authorization were all properly determined to be no longer necessary or useful, and were removed from utility plant in service as long ago as 1990.¹¹⁸ SJWC contends that none of the properties identified in Exhibit DRA-1 would have been suitable for a new Main Office because they are all zoned residential, and four of the five properties are located outside the City of San Jose.

¹¹⁷ Exh. DRA-1, pp.16-17. DRA Opening Brief, pp. 19-21. DRA Reply Brief, pp. 9-10.

¹¹⁸ Exh. SJWC-5, pp. 4-5. SJWC Opening Brief, pp. 15-17. SJWC Reply Brief, pp. 9-10.

Discussion

The only issue concerning the transferred properties relevant to or appropriate for consideration in this proceeding is whether one or more of the transferred properties could have provided a less costly new Main Office. However, no evidence has been offered to show this to be the case.

Although DRA contends that using one of the transferred properties for a new Main Office would be less expensive than SJWC's proposed Alternative 2, DRA did not estimate the cost of building an office at any of the properties.¹¹⁹ Thus, DRA's assertion that building a new Main Office at one of the identified properties would be a less expensive alternative is speculative and unsupported by evidence.

DRA is rightly concerned with utilities' compliance with our regulations. However, the determination as to whether SJWC should have filed applications pursuant to § 851 to sell one or more of the five properties which DRA contends were improperly transferred to SJWLC is not within the scope of this proceeding. These issues should be raised in SJWC's GRC or through a formal complaint.

The 2007 RCP already provides a means for considering the appropriateness of transactions like those of concern to DRA. As discussed above, D.07-05-062 adopted MDRs (Minimum Data Requirements) which Class A water utilities are required to complete as part of their GRC and cost of capital testimony in order to reduce discovery during GRC proceedings.

The MDRs require that, to the extent not included in a previous GRC application, the utilities must include a detailed, complete description

¹¹⁹ TR 353:10-354:23

accounting for all real property that, since January 1, 1996, was at any time, but is no longer, necessary or useful in the performance of the water corporation's duties to the public and explain what, if any, disposition or use has been made of said property since it was determined to no longer be necessary or useful in the performance of utility duties. The disposition of any proceeds must also be explained.¹²⁰

The RCPs specifically require Class A water utilities to provide information on the disposition of real property that is no longer necessary or useful to, among other things, promote timely processing of GRCs and facilitate comprehensive Commission review of the rates and operations of Class A water utilities.¹²¹ Therefore, SJWC's GRC is the appropriate place to raise concerns about SJWC properties which DRA believes were improperly transferred to SJWLC.

Finally, DRA's contention that the proceeds from the sale to third parties of the transferred properties could have been used to reduce future revenue requirements is not within the scope of this proceeding. The sale of the properties in question does not affect the revenue requirement resulting from approval of this Application. Whether and how the proceeds from the sale to third parties of the transferred properties affects SJWC's overall revenue requirement should be considered in a GRC, in a complaint or in another appropriate proceeding.

¹²⁰ D.07-05-062, Appendix A, Attachment 1, Section II.D.8, p. A-27. The 2004 RCP contained this same requirement. (See D.04-06-018, Appendix, p. 10).

¹²¹ D.07-05-062, Appendix A, Section I, p. A-2.

11.3. Purchase of 1265 South Bascom Avenue

DRA states that SJWC has implemented Alternative 2 without waiting for the Commission's decision on the Application and despite the costs to ratepayers.¹²² DRA contends that SJWC should have waited for the Commission's decision before it purchased 1265 South Bascom Avenue because authority to purchase the 1265 South Bascom Avenue building is one of the Application's requests. DRA recommends, therefore, that the Commission void SJWC's purchase of 1265 South Bascom Avenue, and order SJWC to lease only 1,130 ft.² on the first floor of 1265 South Bascom Avenue at a rate of \$13.20 per ft.² per year.

Should the Commission allow SJWC to purchase the 1265 South Bascom Avenue building, DRA recommends that the Commission approve for recovery \$2.7 million (i.e., original cost of \$3.6 million minus \$0.9 million in depreciation). DRA contends that this amount is the book value cost to its affiliate SJWLC, and is consistent with the affiliate transaction rule of "lower of cost or market" that was applied to Cal Water by D.97-12-011.

SJWC states that it does not need the Commission's permission to purchase a building, and did not request in the Application permission to purchase 1265 South Bascom Avenue. SJWC states that it only requested permission to sell the Main Office and to increase rates for the costs associated with implementing Alternative 2.¹²³

Discussion

¹²² DRA Opening Brief, pp. 12-14.

¹²³ SJWC Reply Brief, pp. 7-9.

SJWC has not sought in this Application, and does not require Commission authority, to purchase 1265 South Bascom Avenue. The only question before the Commission in this proceeding with regard to the purchase of 1265 South Bascom Avenue is whether SJWC should be authorized to the recover through rates the costs associated with replacing facilities, including the costs related to the purchase of 1265 South Bascom Avenue.

The Scoping Memo explicitly states that this proceeding will not decide whether SJWC may buy or lease facilities to replace its Main Office, but only whether costs associated with replacing its Main Office should be included in rate base and rates. Therefore, we reject DRA's recommendation to void SJWC's purchase of 1265 South Bascom Avenue, and we will not order SJWC to instead lease space on the first floor of that building.

We also reject DRA's recommendation that the Commission limit the amount approved for recovery to \$2.7 million for the purchase of 1265 South Bascom Avenue. DRA's recommendation to apply the "lower of cost or market" affiliate transaction rule that the Commission applied to Cal Water in D.97-12-011 is inappropriate because that requirement has never applied to SJWC.¹²⁴

DRA asserts that the PD violates Commission policy set forth in D.97-12-011 concerning affiliate transactions.¹²⁵ D.97-12-011 approved a settlement agreement between Commission's Water Division and Cal Water addressing Cal Water's request to reorganize into a holding company structure.

¹²⁴ The requirement established in D.97-12-011 is no longer applicable to Cal Water. D.02-12-068 now requires transfers of tangible and intangible assets and goods to Cal Water to be priced at fair market value (Appendix B, Rule 14).

¹²⁵ Opening Comments of DRA on Proposed Decision of ALJ Smith, p. 10.

D.97-12-011 is not Commission policy because the provisions of a settlement agreement may not be used to establish Commission policy.¹²⁶ DRA's assertion is without merit.

The Commission's SP U-21-W contains affiliate transaction rules applicable to water utilities when the utilities have a holding company and non-regulated affiliates.¹²⁷ SP U-21-W provides that, unless in conflict with statute or other Commission orders, transfers of tangible or intangible assets from an affiliated sister company or a holding company to a water utility shall be at fair market value.¹²⁸ Therefore, we will not adopt DRA's recommendation to apply the "lower of cost or market" to the recovery of costs associated with the purchase of 1265 South Bascom Avenue.

11.4. Alleged Rule 1.1 violation

DRA alleges that SJWC misled the Commission in violation of Rule 1.1 by failing to disclose the fact that SJWC purchased 1265 South Bascom Avenue in May 2007.¹²⁹ DRA states that SJWC had numerous opportunities to disclose this fact to DRA and the Commission but failed to do so during discovery, by amending the Application, or by alerting the Commission during the Second PHC or during DRA's site visit in November 2007.

¹²⁶ Rule 12.5 provides that adoption of a settlement does not constitute approval of, or precedent regarding, any principle or issue in the proceeding or in any future proceeding.

¹²⁷ These guidelines were established by D.00-07-018, as modified by D.03-04-028 and D.04-12-023.

¹²⁸ Rule 21 -Transfers of Tangible and Intangible Assets and Goods to Water Utility, p. 5.

¹²⁹ DRA Opening Brief, pp. 22-26. DRA Reply Brief, pp. 10-11.

DRA contends that SJWC's failure to disclose its purchase of 1265 South Bascom Avenue had a substantive effect on DRA's analysis and on what the Commission understood it was addressing in this proceeding. DRA states that SJWC's conduct is misleading, and recommends that penalties be imposed to deter SJWC from engaging in this type of behavior in a future proceeding.

SJWC states that SJWC's testimony contained in Exhibit SJWC-1, Jensen, at page 3 explicitly states that SJWC will purchase 1265 South Bascom Avenue, and that SJWC requests new rates to reflect adding the \$4.3 million purchase price into SJWC's rate base.¹³⁰

SJWC asserts that DRA mistakenly believes that the Application sought the Commission's advice on how to solve its need for space. Rather, SJWC contends, the Application instead seeks approval of the choice SJWC has made, and provides its alternatives analyses to show the process SJWC used to make its choice so that the Commission could review the reasonableness of SJWC's selection.

Discussion

The record in this proceeding shows that SJWC stated its intention to purchase 1265 South Bascom Avenue at least twice. For example, SJWC states,

"To accomplish the most economic outcome, SJWC will take the following actions...Purchase from SJW Land Company the existing 20,000 square foot office building at 1265 South Bascom Avenue that is adjacent to SJWC's South Bascom Avenue campus.¹³¹

¹³⁰ SJWC Reply Brief, pp. 8-9.

¹³¹ Exh. SJWC-1, Yoo, p. 7.

SJWC similarly states its intention to purchase 1265 South Bascom Avenue at Exhibit SJWC-1, Jensen, page 3. Thus, SJWC has not misled the Commission because the Application clearly states SJWC's intention to purchase 1265 South Bascom Avenue.

Although SJWC did not affirmatively alert the Commission that the purchase had taken place, it was under no obligation to do so because SJWC does not need the Commission's approval to purchase property. If SJWC chooses to purchase property for utility use before the Commission approves recovery of the costs in connection with the purchase, it does so at its own risk. SJWC also testified truthfully when asked about the status of the ownership of 1265 South Bascom Avenue.¹³²

There is no evidence that SJWC made a false statement concerning the purchase of 1265 South Bascom Avenue, or in any other way attempted to mislead the Commission about the purchase of that property. Therefore, SJWC did not violate Rule 1.1, and we reject DRA's recommendation for penalties.

12. Comments on Proposed Decision

The proposed decision in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on September 8, 2008, by DRA and SJWC, and reply comments were filed on September 15, 2008, by DRA and SJWC. In addition to the comments that we have addressed explicitly, including changes to Appendix D to reflect rate changes that have occurred since SJWC's last GRC, we

¹³² TR 58:7-60:6.

have reviewed all the comments and replies and revised the decision as warranted.

13. Assignment of Proceeding

Dian M. Grueneich is the assigned Commissioner and Richard Smith is the assigned ALJ in this proceeding.

Findings of Fact

1. The 2004 and 2007 RCPs do not prohibit Class A water utilities from filing applications, rate base offsets or requests for other proceedings between scheduled GRCs.

2. The Main Office was designated a City Historical Landmark in 1991 and, due to its historic status, the City requires an historic preservation permit to perform any work or cause any work to be performed on it.

3. Factors such as building security, ability to upgrade the building's systems and infrastructure, level of workplace noise, and access to customer service facilities for the physically disabled are necessary attributes to ensuring adequate facilities.

4. The handrails, fixtures, door hardware and restrooms in the Main Office do not comply with ADA requirements; the existing interior ramps do not comply with the building code; it is not possible to install an elevator in the Main Office to provide access for physically disabled employees or customers; and the set back from Santa Clara Street does not allow for a ramp at the main entrance to the Main Office, requiring physically disabled customers and employees to use the rear entrance.

5. Adequate access for the physically disabled cannot be provided given limited modifications that can be made to the Main Office as a designated historic landmark. If SJWC is required to retain the Main Office, physically

disabled customers will be permanently denied reasonable access to SJWC's customer service center.

6. Requiring physically disabled persons to use the rear entrance of the Main Office is disruptive to employees' normal work activities when they are required to serve as impromptu escorts and is not an efficient use of utility personnel.

7. The rear entrance of the Main Office should remain locked for security purposes, and requiring physically disabled persons to use the rear entrance undermines the security of the facility.

8. As an historic landmark, security improvements such as card reader access locks or separation between customer and employee areas cannot be made to the Main Office to ensure the safety of SJWC's employees and customers.

9. Providing access for the public at another existing SJWC facility will not enhance the security of employees who remain at the Main Office.

10. The work environment in the Main Office is adversely affected by aircraft and freeway noise, but the historical landmark status of the building makes it impossible to implement adequate sound reduction improvements.

11. The Main Office cannot be sufficiently renovated to support upgrades to the air conditioning, plumbing, heating, electrical and communications systems due to the building's design, the materials used to construct it, and limitations on improvements that can be made to the Main Office as an historic landmark.

12. Requiring SJWC to remodel the Main Office and to use space at 1251 South Bascom Avenue or 1265 South Bascom Avenue unreasonably constrains SJWC's ability to situate its staff for optimal operational efficiency because SJWC will have to locate staff from the same departments in separate locations.

13. The Main Office is not an adequate facility because it cannot be sufficiently remodeled to upgrade the building's systems and infrastructure, provide

reasonable access for disabled persons, provide a secure and adequate work environment, or provide flexibility to collocate departmental staff.

14. Requiring SJWC to retain and remodel the Main Office will not provide adequate facilities.

15. The revenue effects on ratepayers should be included in the DCF analyses of Alternatives 1 and 2 to reflect the true costs to ratepayers so that the NPVs and revenue requirements for these alternatives may be compared on an “apples-to-apples” basis.

16. The DCF analyses should include return on investment costs paid to SJWC’s shareholders by SJWC’s ratepayers because excluding these costs related to the purchases of the Replacement Facility and 1265 South Bascom Avenue understates the actual costs of the different options.

17. Because the tax effect on debt is different from that for equity, 1.4173 should be used as the NTG multiplier when calculating the revenue requirement for this project.

18. The purchase of the Replacement Facility is not eligible for tax deferral as a Section 1031 property exchange.

19. The NPV of the Alternative 1 is \$25,598,558.

20. The revenue requirement of Alternative 1 is \$1,133,520.

21. Alternatives 1 and 2 both provide adequate facilities, but Alternative 1 results in a lower revenue requirement than Alternative 2.

22. SJWC’s request to recover 50% of the revenue requirement through the service charge component and the remaining 50% through the quantity rate component of its tariffed rates is consistent with Commission policy.

23. The Main Office is currently in rate base and generating a revenue requirement, is currently occupied and used to provide utility service, and will

continue to be necessary and useful for providing utility service at, and after, the time of sale.

24. The net proceeds from the sale of the Main Office are not eligible for reinvestment pursuant to § 790.

25. The net proceeds from the sale of the Main Office are \$1,525,193.

26. The Percentage Allocation Rule provides that utility ratepayers receive 100% of the gains or losses on the sale of depreciable water utility assets, and ratepayers and shareholders split the gains or losses from non-depreciable property 67%-33%, respectively.

27. If the net proceeds from the sale of the Main Office are apportioned according to book values, the non-depreciable land accounts for 2.4% of the gain to be split "67/33" between ratepayers and shareholders, and depreciable structures and improvements account for 97.6% of the gain that should be allocated 100% to ratepayers.

28. The ratepayers' share of the gain on the sale of the Main Office is \$1,513,209.

29. D.06-11-015 approved a settlement between SJWC and DRA on SJWC's most recent GRC, including approval of the lease payments to SJWLC for the 1265 South Bascom Avenue facility.

30. SJWC has not requested and does not require Commission authority to purchase 1265 South Bascom Avenue.

31. The Commission's affiliate transaction rules in SP U-21-W are applicable to water utilities when the utilities have a holding company and non-regulated affiliates. These rules provide that, unless in conflict with statute or other Commission orders, transfers of tangible or intangible assets from an affiliate or its holding company to a water utility shall be at fair market value.

32. SJWC did not make a false statement to the Commission or attempt to mislead the Commission about the purchase of 1265 South Bascom Avenue.

Conclusions of Law

1. SJWC should be authorized to sell the Main Office because it is not an adequate facility.

2. The agreed upon selling price of \$4,000,000 for the Main Office is reasonable.

3. The net proceeds from the sale of the Main Office should be allocated to ratepayers and shareholders pursuant to the Percentage Allocation Rule.

4. The ratepayers' share of the net proceeds from the sale of the Main Office should be distributed to customers through a monthly surcredit to customer bills for a period not to exceed one year.

5. The estimated proceeds from the future sale of the Replacement Facility and 1265 South Bascom Avenue should not be included in DCF analyses because the reasonableness of the sale prices or the eligibility of the sales proceeds for reinvestment in utility property are beyond the scope of this proceeding.

6. The DCF analysis of Alternative 2 should not include the full \$6.7 million purchase price for the Replacement Facility because it is not requested in the Application, and it is beyond the scope of this proceeding to anticipate a future application that SJWC may file to seek recovery of the remainder of the purchase price, or to consider in this proceeding issues appropriate for that yet-to-be-filed application.

7. The DCF analyses should not include income derived from leasing excess space in the Replacement Facility because that excess space is not property necessary or useful in the performance of SJWC's duties to the public and will not be included in rate base.

8. The DCF analysis of Alternative 1 should be revised to escalate estimated parking fees at 3% per year for all years analyzed, and should be revised to exclude O&M costs.

9. The DCF analyses should use 1.4173 as the NTG multiplier to reflect the weighted cost of debt and equity.

10. Depreciation expense should be based on gross plant.

11. The DCF analyses should not include the deferral of taxes allowed under the Internal Revenue Code.

12. An alternative that may cost less but which results in inadequate facilities is not in the best interests of ratepayers.

13. The increase of \$1,133,520 in the revenue requirement for 2008 is reasonable and should be approved.

14. The determination of whether SJWC should be authorized to include in rate base some or all of the costs for the purchase of 110 West Taylor Street or the purchase of 1265 South Bascom Avenue should be deferred to SJWC's next GRC.

15. SJWC should be authorized to establish a memorandum account to track costs associated with the purchase of 110 West Taylor Street or the purchase of 1265 South Bascom Avenue, including interim depreciation and other expenses, such as taxes, for retroactive recovery.

16. Commission approval to sell necessary or useful utility property does not render property unnecessary or no longer useful.

17. SJWC's request for authorization to reinvest the net proceeds from the sale of its Main Office in infrastructure pursuant to § 790 should be denied.

18. SJWC's lease payments to SJWLC for the 1265 South Bascom Avenue facility are not relevant to this proceeding because those payments were

approved by D.06-11-015, and modification of D.06-11-015 is beyond the scope of this proceeding.

19. Issues concerning whether SJWC should have filed other applications pursuant to § 851 to sell one or more of the five properties which DRA contends were improperly transferred to SJWLC are beyond the scope of this proceeding.

20. Whether and how the proceeds from the sale to third parties of the transferred properties affects SJWC's overall revenue requirement are beyond the scope of this proceeding.

21. SJWC was under no obligation to affirmatively alert the Commission that it purchased 1265 South Bascom Avenue.

22. SJWC did not violate Rule 1.1.

23. Today's order should be made effective immediately.

O R D E R

IT IS ORDERED that:

1. San Jose Water Company's (SJWC's) application for Commission authority pursuant to Pub. Util. Code § 851 to sell its Main Office located at 374 West Santa Clara Street, San Jose, is granted.

2. An increase of \$1,133,520 in SJWC's revenue requirement for 2008 is approved.

3. As shown in Appendix D to this decision, 50% of the additional revenue requirement shall be recovered through the service charge component of SJWC's tariffed rates and the remainder shall be recovered through the quantity rate component of SJWC's tariffed rates.

4. The determination of whether SJWC should be authorized to include in rate base some or all of the costs for the purchase of 110 West Taylor Street or the

purchase of 1265 South Bascom Avenue shall be deferred to SJWC's next general rate case.

5. SJWC is authorized to establish a memorandum account to track costs associated with the purchase of 110 West Taylor Street or the purchase of 1265 South Bascom Avenue, including interim depreciation and other expenses, such as taxes, for retroactive recovery.

6. SJWC's request for a Commission determination that its Main Office is no longer necessary or useful is denied.

7. SJWC's request for authorization to reinvest the net proceeds from the sale in infrastructure pursuant to Pub. Util. Code § 790 is denied.

8. The net proceeds of \$1,525,193 from the sale of the Main Office shall be apportioned to SJWC's shareholders and customers in accordance with the Percentage Allocation Rule.

9. The SJWC's customers' share from the gain on the sale of the Main Office in the amount of \$1,513,209 shall be distributed to SJWC's customers through a monthly surcredit to customer bills for a period not to exceed one year.

10. Application 07-01-035 is closed.

11. This order is effective today.

Dated October 2, 2008, at San Francisco, California.

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
TIMOTHY ALAN SIMON
Commissioners

I will file a concurrence.

/s/ JOHN BOHN
Commissioner

I reserve the right to file a concurrence.

/s/ DIAN GRUENEICH
Commissioner

APPENDIX A

SJW Summary of Costs - Cash Flow Impact				
Description	Capital Outlay in 2006 Dollars - Alternative 1	Capital Outlay in 2006 Dollars - Alternative 2	Present Value of Total Costs - Alternative 1	Present Value of Total Costs - Alternative 2
374 W. Santa Clara Street (Headquarters)	N/A	N/A	N/A	N/A
Building renovated in Base Case, sold in Alternatives 1 and 2.				
1221 A Bascom (Operations Building)	\$414,912	\$414,912	\$1,866,410	\$1,866,410
Building unchanged in Base Case, renovated in Alternatives 1 and 2.				
1251 Bascom (Purchasing Building)	\$697,511	\$697,511	\$1,389,948	\$1,389,948
Building unchanged in Base Case, renovated in Alternatives 1 and 2.				
1265 Bascom (Engineering Building)	\$1,334,310	\$5,634,310	\$8,748,157	\$14,275,038
First and second floors leased with first floor renovated in Alternative 1; building purchased in Alternative 2.				
1265 Bascom - 1st Floor	N/A	N/A	N/A	N/A
3,980 sf is leased at 1265 Bascom in Base Case				
Downtown Leased/Purchased Space	\$1,929,011	\$6,174,857	\$13,594,043	\$15,142,888
Downtown space leased in Alternative 1 (15,180sf); purchased in Alternative 2				
TOTAL	\$4,375,745	\$12,921,591	\$25,598,558	\$32,674,284

(END OF APPENDIX A)

APPENDIX B

Alternative 1				
Cost & Revenue Requirement Summary				
	Description			Year 1
1	1221 Bascom			
2	Renovation			\$414,912
3	Total Actual Costs			\$414,912
4				
6	1251 Bascom			
7	Construction			\$679,061
8	One time relocation costs			\$18,450
9	Total Actual Costs			\$697,511
10				
11	1265 Bascom			
12	Construction upgrades			\$1,282,810
13	One time relocation costs			\$51,500
14	Rent 1st floor (lease)			\$132,000
15	Total Actual Costs			\$1,466,310
16				
17	New Downtown office			
18	Renovation			\$1,853,111
19	One time relocation costs			\$75,900
20	Rent (lease)			\$412,775
21	Parking			\$72,864
22	Total Actual Costs			\$2,414,650
23				
25		1265	Downtown	Total
27	Total Depreciable Capital Additions	\$1,282,810	\$1,853,111	\$4,229,894
28	Total Expenses	\$183,500	\$561,539	\$763,489
29	374 W. Santa Clara St. Disposal and Retirements	(\$587,688)	(\$848,958)	(\$1,937,824)
30				
31	Dep. Asset Addition (Lines 27+29)	\$695,122	\$1,004,153	\$2,292,070
32				
33	Adjustment in Earnings for Rate of Return of 8.9% (Line 31* 8.9%)	\$ 61,866	\$ 89,370	\$203,994
34	Adjustment for Net to Gross Multiplier of 1.4173 (Line 33* 1.4173)	\$ 87,682	\$ 126,664	\$289,121
35	Adjustment in Depreciation Expense (Line 31/40 Years)	\$17,378	\$25,104	\$57,302
36	Adjustment in Property Tax of 1.03% (Line 31* 1.03%)	\$ 7,160	\$ 10,343	\$23,608
37	Total Increase in Revenue Requirement (Lines 28+34+35+36)	\$ 295,720	\$ 723,649	\$ 1,133,520

(END OF APPENDIX B)

APPENDIX C

Alternative 2				
Cost & Revenue Requirement Summary				
	Description			Year 1 2007
1	1221 South Bascom Ave.			
2	Renovation/Construction			\$414,912
3	Total Actual Costs			\$414,912
4				
5	1251 South Bascom Ave.			
6	Construction			\$679,061
7	One Time Relocation Costs - Move Out			\$3,000
8	One Time Relocation Costs - Move In			\$15,450
9	Total Actual Costs			\$697,511
10				
11	1265 South Bascom Ave.			
12	Purchase			\$4,300,000
13	Construction/Renovation Costs			\$1,282,810
14	One Time Relocation Costs - Move In			\$51,500
15	Credit for Rent Paid for 2nd Floor (now in rates)			(\$417,720)
16	Total Actual Costs			\$5,216,590
17				
18	New Downtown Office and Customer Service Facility			
19	Purchase			\$3,795,000
20	One Time Relocation Costs - Move In			\$75,900
21	Construction/Renovation Costs			\$2,303,957
22	Total Actual Costs			\$6,174,857
23				
24				
25		1265	Downtown	Total
26				
27	Total Depreciable Capital	\$5,582,810	\$6,098,957	\$12,775,741
28	Total Expenses	(366,220)	75,900	(271,870)
29	374 W. Santa Clara St. Disposal and Retirements	(\$846,801)	(\$925,090)	(\$1,937,824)
30				
31	Dep. Asset Addition (Lines 27+29)	\$4,736,010	\$5,173,868	\$10,837,917
32				
33	Adjustment in Earnings for Rate of Return of 8.9% (Line 31* 8.9%)	\$421,505	\$460,474	\$964,575
34	Adjustment for Net to Gross Multiplier of 1.4173 (Line 33* 1.4173)	\$597,399	\$652,630	\$1,367,092
35	Adjustment in Depreciation Expense (Line 31/40 Years)	\$118,400	\$129,347	\$270,948
36	Adjustment in Property Tax of 1.03% (Line 31* 1.03%)	\$48,781	\$53,291	\$111,631
37	Total Increase in Revenue Requirement (Lines 28+34+35+36)	\$398,360	\$911,168	\$1,477,800

(END OF APPENDIX C)

APPENDIX D

SAN JOSE WATER COMPANY (U-168-W)									
Adopted Revenue Requirement and Rates									
	Total Expenses					\$763,489			
	Total Allowable Plant Additions					\$2,292,070			
	Adjustment in Earnings for Rate of Return					\$203,994			
	Adjustment for Net to Gross Multiplier					\$289,121			
	Adjustment in Depreciation Expense					\$57,302			
	Adjustment in Property Tax					\$23,608			
	Total Increase in Costs					\$1,133,520			
	To be Recovered in Meter Charge					\$566,760			
	To be Recovered in Quantity Rate					\$566,760			
QUANTITY RATE CALCULATION									
	Total Revenue to be Recovered (G)	Authorized Revenue Res. W-4705 (AL 389)	Total Revenue Increase (%)	Revenue to be Recovered in Quan. Rate (I) (\$)	2007 Adopted Usage D.06-11-015 (Att. A) (ccf)	Quantity Rate Increase (\$/ccf)	Quantity Rate (\$/ccf)	New Quantity Rate (\$/ccf)	Quantity Rate Increase (%)
Total Schedules Nos. 1 & 1B	1,133,520	186,684,475	0.61%	566,760	60,591,000	0.0094		2.2279	0.42%
								2.2373	
METER CHARGE CALCULATION									
Revenue to be Recovered in Meter Charge				(H)	\$566,760				
Schedule No. 1. General Metered Service & 1B General Metered Service with Automatic Fire Sprinkler System:									
Meter Size	No. of Customers 2007	No. of Billings	Meter Ratio (SP U-25)	Meter Ratio Equiv	Meter Charge Increase (\$/Month)	Total Service Charge	Current Meter Charge (\$/Month)	New Meter Charge (\$/Month)	Meter Charge Increase (%)
5/8	833	9,996	1.5	14,994	\$0.163423	\$1,634	14.13	14.29	1.16%
3/4	174,865	2,098,380	1.5	3,147,570	\$0.163423	\$342,923	14.13	14.29	1.16%
1	29,122	349,464	2.5	873,660	\$0.272372	\$95,184	23.55	23.82	1.16%
1 1/2	3,918	47,016	5.0	235,080	\$0.544743	\$25,612	47.11	47.65	1.16%
2	4,465	53,580	8.0	428,640	\$0.871589	\$46,700	75.36	76.23	1.16%
3	1,423	17,076	15.0	256,140	\$1.634229	\$27,906	141.30	142.93	1.16%
4	383	4,596	25.0	114,900	\$2.723715	\$12,518	235.50	238.22	1.16%
6	156	1,872	50.0	93,600	\$5.447431	\$10,198	471.01	476.46	1.16%
8	29	348	80.0	27,840	\$8.715889	\$3,033	753.62	762.34	1.16%
10	7	84	115.0	9,660	\$12.529090	\$1,052	1,083.33	1,095.86	1.16%
	215,201	2,582,412		5,202,084		\$566,760			
Schedule No. RCW. Recycled Water Service:									
3/4	0	0	1.5	0	\$0.163423	\$0	14.13	14.29	1.16%
1	2	24	2.5	60	\$0.272372	\$7	23.55	23.82	1.16%
1 1/2	1	12	5.0	60	\$0.544743	\$7	47.11	47.65	1.16%
2	4	48	8.0	384	\$0.871589	\$42	75.36	76.23	1.16%
3	8	96	15.0	1,440	\$1.634229	\$157	141.30	142.93	1.16%
4	22	264	25.0	6,600	\$2.723715	\$719	235.50	238.22	1.16%
6	1	12	50.0	600	\$5.447431	\$65	471.01	476.46	1.16%
8	3	36	80.0	2,880	\$8.715889	\$314	753.62	762.34	1.16%
10	1	12	115.0	1,380	\$12.529090	\$150	1,083.33	1,095.86	1.16%
	42	504		13,404		\$1,461			
Total Meter Charges for all Schedules					5,215,488		\$568,221	566,760	
Bill Comparison Residential 3/4-Inch Meter									
	Usage (ccf)	Rates AL 389	New Rates	Increase					
	5	\$25.27	\$25.48	0.83%					
	10	\$36.41	\$36.67	0.71%					
Average:	15	\$47.55	\$47.85	0.63%					
	20	\$58.69	\$59.04	0.60%					
	30	\$80.97	\$81.41	0.54%					
	50	\$125.53	\$126.16	0.50%					
	100	\$236.92	\$238.02	0.46%					

(END OF APPENDIX D)

Concurrence of Commissioner John Bohn

Today's decision correctly resolves the ratemaking treatment for the main office for San Jose Water Company (SJWC). However, the facts of this case highlight a need to provide additional clarity on how to achieve compliance with Section 790 when large assets are no longer used and useful. Because this is the first water case to arise since the adoption of the Commission's Gain on Sale decision (D.06-05-041), it highlights the interconnectedness of the Gain on Sale provisions under Section 851 and the Section 790 reinvestment provisions. But this decision does not go far enough. Our administrative law judges and the utilities subject to our jurisdiction need a roadmap that addresses the dilemma water utilities face in replacing inadequate facilities in a manner in which they may take advantage of the reinvestment opportunities pursuant to Section 790.

I would like to explore ways in which this dilemma could be resolved. It is not our intention to disadvantage either the customers or the shareholders of any utility under our jurisdiction through the application of our regulations. This decision has brought forward a conflict that could result in the loss of benefit for the utility's shareholders and the loss of reinvestment opportunities that would be of benefit to the utility and its customers. Today's Decision is the first time since the Gain on Sale Decision that the Commission has considered a water utility's request to dispose of real property and to reinvest the proceeds from the sale pursuant to Section 790. SJWC's application highlights the difficulties water utilities face in taking advantage of reinvestment opportunities pursuant to Section 790.

Under current regulation, water utilities face a dilemma. They may either (1) Seek Commission approval prior to removing property from rate base to avoid violating Section 851 (as SJWC did in this case), and in so doing ensure that proceeds from the sale are not eligible for reinvestment pursuant to Section 790; or (2) Remove the property from rate base and dispose of it, and risk violating Section 851 if the Commission later determines the property was necessary or useful. I would like to ensure that in the future, water utilities have every opportunity and incentive to reinvest proceeds from the sale of assets pursuant to Section 790 in appropriate ways in cases like this one.

A.07-01-035

D.08-10-018

There are two possible ways the Commission could approach this dilemma. Let us not seek legislative changes to Section 790, a daunting task. We should instead revisit the requirements established in the Gain on Sale Decision. The Commission should establish a provision that, pursuant to a Section 851 application, a Commission finding that a real property asset is inadequate for utility service is sufficient to authorize a water utility to remove the asset from service and rate base (i.e., to classify the asset as no longer necessary or useful). This would allow the utility to sell the asset and to reinvest the proceeds from the sale pursuant to Section 790.

This is an opportunity to further refine our goal of encouraging proper reinvestment in water infrastructure. I will seek support from my fellow Commissioners to advance this improvement in the Gain on Sale decision.

/s/ JOHN A. BOHN

John A. Bohn
Commissioner

San Francisco, CA

October 2, 2008