

WATER/FLC/SNR/PTL/HJL/jrb

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

WATER & AUDITS DIVISION

RESOLUTION NO. W-4647

June 21, 2007

**R E S O L U T I O N**

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

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**SUMMARY**

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

Paragraph 6 of the Second Amendment states:

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

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

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

## **BACKGROUND**

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

### **System Description:**

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

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

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

### **Purchase Agreement:**

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

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

### **NOTICE, PROTESTS, AND PUBLIC MEETING**

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

- September 21, 2005: The Redwood Mutual board of directors publicly announced their intentions to sell the water system assets at a gathering of residents of Redwood Estates. San Jose made a presentation to the residents and distributed a frequently asked question form.
- September 23, 2005: San Jose made a presentation to the seven wholesale water companies serviced by Redwood Mutual.
- October 3, 2005: Members of the Redwood Mutual board of directors and San Jose conducted a panel discussion, with approximately 200 residents of Redwood Estates.
- November 4, 2005: San Jose participated in a panel discussion conducted by a small group of Redwood Mutual stockholders who were opposed to the transaction. Approximately 45 residents attended.
- December 12, 2005: Members of the Redwood Mutual board of directors and San Jose conducted a panel discussion, with approximately 12 former officers of the Redwood Mutual board to respond to questions.
- December 14, 2005: Members of the Redwood Mutual board of directors and San Jose conducted a panel discussion, with approximately 120 residents of Redwood Estates, to respond to questions.
- January 9, 2006: San Jose and members of the Redwood Mutual board of directors met with the seven wholesale water companies serviced by Redwood Mutual, to discuss the proposed transaction.

- February 6, 2006: Members of the Redwood Mutual board of directors conducted a final panel discussion, with approximately 70 residents of Redwood Estates to answer questions.

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

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

## **DISCUSSION**

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

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

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

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

“2. The rules set forth in Appendix D, as clarified by this decision with respect to the requirement that a Commission decision or resolution authorizing rates is a prerequisite to the implementation of rates for an

acquired utility, are established as the operating procedures in accordance with Pub. Util. Code §§ 718, et. seq., the Public Water System Investment and Consolidation Act of 1997, effective January 1, 1998.”

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

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

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

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

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

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

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

**System Integration:**

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

**Rates:**

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

Although the Mountain District had the same source of supply as other San Jose customers, there was significant additional costs associated with lifting the water to the mountainous Redwood Estates area. Additionally, the Mountain District has urgent capital improvement needs which will be funded through the higher rates. Finally, due

to the limited capacity of the Montevina pipeline the rate structure must encourage a 250 gpd per customer limit until system upgrades have been completed. Although the planned system upgrades will improve the daily water usage limit by 50% to 375 gpd for the Mountain District customers, including the mutuals, it is essential to maintain the tiered rate design in order to encourage compliance with the usage limit. The proposed differential in rates between San Jose's current service area and San Jose's Mountain District is justified and reasonable.

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

### **Conservation**

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

### **COMPLIANCE**

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

### **COMMENTS**

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

#### **Comments of Brush and Old Well Mutual Water Company**

On May 15, 2007, the Water Division received comments from Brush and Old Well Mutual Water Company (Brush).

In its comments, Brush summarized its background and relationship with San Jose, how the water system was established, a brief system description, and how its storage

facilities are tied into San Jose's SCADA system. Brush is not geographically located within San Jose's Mountain District service territory.

Brush also discussed the obligations for the Montevina Pipeline and how its repairs were funding following the 1989 Loma Prieta earthquake.

Brush argued that the rates are unsubstantiated, arbitrary, and unfairly discriminate against the Mountain District customers and Brush as a wholesale purchaser of the Montevina Pipeline.

Brush asserted that San Jose failed to provide adequate due process to Brush during its implementation of Advice Letter No. 365 and subsequent advice letters.

### **Comments of San Jose**

On May 22, 2007, San Jose responded to Brush's comments discussed above.

In its comments, San Jose states that although the other mutual water companies may have contributed to the Montevina Pipeline following the Loma Prieta earthquake in 1991, the California Department of Water Resources recognized Redwood Mutual as the legal owner. In addition, all facilities acquired from Redwood Mutual by San Jose have been booked as contributed plant. Hence, San Jose will not be earning a rate of return on any such facilities.

With respect to unsubstantiated and unreasonable rates, San Jose reiterated that at the time of acquisition, San Jose adopted rates which were approved by the Redwood Mutual board of directors, and in effect for nine months prior to the acquisition. In compliance with the acquisition agreement, the outside mutual water companies, including Brush, are charged a \$42 per month readiness-to-serve fee in comparison to the \$75 fee charged to the former members of the Redwood Mutual.

With respect to adequate notification and due process, San Jose detailed mailing notifications and list of public meetings which were conducted. In addition, San Jose points out that Brush representatives visited San Jose to review the acquisition advice letter as well as the filed service area map.

### **Discussion of Comments**

While AL No. 365-A lacked a resolution, it was in compliance with the Commission's policies and procedures with respect to mergers and acquisitions. Also, AL No. 365-A did not address the rate increase, which instead, is being handled in this resolution, which all parties have had notice for.

This resolution provides adequate analysis of the requested increase.

**FINDINGS**

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

**THEREFORE IT IS ORDERED THAT:**

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

I certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on June 21, 2007; the following Commissioners voting favorably thereon:

/s/ PAUL CLANON

Paul Clanon  
Executive Director

MICHAEL R. PEEVEY  
President

DIAN M. GRUENEICH

JOHN A. BOHN

RACHELLE B. CHONG

TIMOTHY ALAN SIMON

Commissioners