Decision 09-11-032 November 20, 2009

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of San Jose Water Company (U168W) for an Order authorizing it to increase rates charged for water service by $36,207,000 or 18.44% in 2010, by $15,171,000 or 6.52% in 2011, and by $19,899,000 or 8.10% in 2012.	Application 09-01-009 (Filed January 21, 2009)

Nossaman, Guthner, Knox & Elliott, LLP, by Martin A. Mattes, Attorney at Law, for San Jose Water Company, applicant.

Jeffrey L. Bates, for Redwood Estates Services Association; Bob Burk and Robert Jones, for Big Redwood Park Mutual Water Co., Brush & Old Well Road Mutual Water Co., Mountain Summit Mutual Water Co., Oakmont Water Company, Ridge Mutual Water Company, Summit West Mutual Water Co., and Villa Del Monte Mutual Water Co.; and Maria L. Bondonno, Attorney at Law, for the Commission's Division of Ratepayer Advocates, interested parties.

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DECISION RESOLVING GENERAL RATE CASE OF SAN JOSE WATER COMPANY

Summary

San Jose Water Company (SJWC) is authorized to increase rates by amounts designed to increase revenue by $18,597,000 or 9.24% in its test year 2010, $7,558,000 or 3.43% in 2011, and $11,088,000 or 4.87% in 2012. As a result of the revenue increase granted by this decision, the monthly bill for the average SJWC residential customers using 15 Ccf of water with a 5/8" by 3/4" meter would increase by $4.01 or 8.19% to $52.99 from $48.98 for the test year 2010.

1. Background

San Jose Water Company (SJWC) provides public utility water service to approximately 223,000 residential and industrial customers within its 140 square-mile Santa Clara County service territory. Its service territory encompasses parts of Cupertino, San Jose, and Santa Clara, and in Campbell, Los Gatos, Monte Sereno, and Saratoga, as well as portions of unincorporated Santa Clara County.

SJWC is a wholly owned subsidiary of San Jose Water Corporation. San Jose Water Corporation also owns approximately 5 percent (5%) of California Water Service Group, formerly known as California Water Service Company. SJWC's last general rate case (GRC) was for a 2007 test year, which was resolved by a settlement agreement adopted by Decision (D.) 06-11-015 in 2006.

On January 21, 2009, SJWC filed the above-captioned application to increase rates charged for water service within its service territory by $36,207,000 or 18.44% in 2010, by $15,171,000 or 6.52% in 2011, and by $19,899,000 or 8.10% in 2012. SJWC also requested authority to create two new memorandum accounts to track costs for: (1) Fluoride Implementation, and (2) Pension Expenses. In addition, SJWC requested authority to eliminate the $500,000 ceiling limit in its existing Water Quality Memorandum Account (WQMA), zero out the amounts

in its Water Quality Memorandum and Balancing Accounts, and continue its Water Rate Assistance Balancing Account.

Notices of the application were provided to the public through postings in offices, newspaper publications, and by mailings to each customer and to all cities and public agencies in the service territory.

A public participation hearing was held in San Jose on June 8, 2009. Approximately 30 of the 100 people who attended the meeting spoke against any rate increase. There were no complaints about the water service they receive from SJWC.

2. Joint Comparison Exhibit

At the March 19, 2009 Prehearing Conference (PHC), the assigned Administrative Law Judge (ALJ) ordered all active parties to participate in settlement discussions subsequent to the tendering of interested parties' testimony and prior to the start of an evidentiary hearing.[1] ALJ Janet Econome was assigned as a neutral ALJ to mediate settlement discussions prior to the scheduled evidentiary hearing on June 17, 2009. At the evidentiary hearing, it was reported that the mediation process resulted in progress on settlement of many of the contested issues between the parties and that they were working on a document that identified settled issues and a comparison table that identified the remaining revenue requirement difference between SJWC and the DRA.

[1] Active parties consisted of SJWC, the Commission's Division of Ratepayer Advocates (DRA), Redwood Estates Services Association and, appearing jointly, seven mutual water companies. The mutual water companies were (1) Big Redwood Park Mutual Water Company, (2) Brush & Old Well Road Mutual Water Company, (3) Mountain Summit Mutual Water Company, (4) Oakmont Water Company, (5) Ridge Mutual Water Company, (6) Summit West Mutual Water Company, and (7) Villa Del Monte Mutual Water Company.

Late-filed Exhibit 36 was reserved for a joint SJWC and DRA comparative test year 2010 results of operation schedule to show differences between SJWC and DRA prior to and subsequent to a partial settlement. Late-Filed Exhibit 36 was subsequently received into evidence on August 9, 2009.

3. Settlement Agreements

There were two settlement agreements in this proceeding, a partial results of operations agreement and an all-party rate design agreement. These settlement agreements are attached to the decision as Appendices B and C, respectively.

The partial settlement agreement, filed on August 19, 2009 as amended on August 26, 2009, resulted in SJWC reducing its requested 2010 test year net operating revenue by $481,000 to $37,401,000 from $37,882,000 and its rate base by $5,676,000 to $425,010,000 from $430,686,000. DRA increased its recommended 2010 test year net operating revenue by $389,000 to $33,355,000 from $32,966,000 and rate base by $7,749,000 to $378,984,000 from $371,235,000.

These revised test year estimates resulted from a review of initial positions, correction of errors, and a better understanding of the other party's estimates. Many of those agreements stemmed from the availability of more recent data to DRA after SJWC filed its application.

An all-party rate design settlement agreement was attached to the partial results of operations settlement agreement filed on August 19, 2009. The only changes to SJWC's rate design, which is consistent with the Commission's D.86-05-064 rate design policy, pertained to SJWC's Mountain District. This agreement resolved all of the issues raised by the Mutual Water Companies and the Redwood Estates Services Association obtaining water service in SJWC's Mountain District. Under the terms of the settlement agreement, Mountain District customers would pay the same service charges in effect for all of SJWC's

remaining customers. It also provided for an increase in the current water use restriction to 500 gallons per day per service from 400 gallons and established an Interruptible Service Clause tariff.

Upon careful analysis of the record and consideration of reasons for the parties' initial and revised estimates and rate design, we find that the partial results of operations and all-party rate design settlement agreements are a reasonable resolution of the issues, consistent with the law, and in the public interest. Pursuant to Rule 12.5 of the Commission's Rules of Practice and Procedure (Rules), the adoption of these settlement agreements does not constitute approval of any principle or issue in this proceeding and should not be cited as precedent in any future proceeding.

4. Disputed Issues

Not resolved by the settlement agreements were operating and rate base differences that impact the 2010 test year results of operation and rate base, need for a Fluoride Memorandum Account, and affiliated company activities. The test year results of operations and rate base differences set forth in the comparative exhibit attached to SJWC and DRA's partial settlement agreement are summarized in the following table. Discussions of these differences follow the table. The memorandum account and affiliated company activities issues, not impacting the test year results of operations, are also addressed.

	Dollars in Thousands[2]		
Category	**SJWC**	**DRA**	**SJWC > DRA**
Operating Revenue	$223,385	$208,000	$15,385
Operating Expenses	185,985	174,645	11,340
Net Operating Revenue	37,401	33,355	4,045
Rate Base	$425,010	$378,984	$46,026

5. Operating Revenue

The $15,385,000 difference in test year operating revenue between SJWC and DRA resulted from an $11,340,000 difference in operating expenses and a $46,026,000 difference in rate base. SJWC and DRA concurred on the number of customers by customer class and in the basic water consumption patterns of customers. SJWC and DRA also applied an 8.80% return on their recommended rate bases and a 1.6959 net to gross multiplier to their resultant net operating revenues to derive their recommended operating revenue. We find it reasonable to apply an 8.80% return to the rate base being adopted in this proceeding and a 1.6959 net to gross multiplier to the net operating revenue being adopted in this proceeding to derive the gross operating revenue requirement.

6. Operating Expense

The $11,340,000 difference in test year operating expenses between SJWC and DRA was in: (1) Purchased Power; (2) Recycled Water Retrofit; (3) Uncollectible Revenue; (4) Non-Tariff Services; (5) Other Operating & Maintenance; (6) Rent; (7) Other Administrative & General; (8) Taxes, Other Than

[2] Amounts are rounded to the nearest thousand. For example, $500 is rounded up to $1,000. There are also minor differences due to rounding.

Income; (9) Depreciation; and, (10) Income Taxes, as shown in the following table.

	Dollars in Thousands		
Category	**SJWC**	**DRA**	**SJWC > DRA**
OPERATING EXPENSES			
(1) Purchased Power	$7,676	$7,712	$ -36
(2) Recycled Water Retrofit	1,099	0	1,099
(3) Uncollectible Revenue	518	483	35
(4) Non-Tariff Services	-432	-456	24
(5) Other Operating & Maintenance	29,256	29,283	-27
(6) Rent	529	862	-333
(7) Other Administration & General	7,014	7,035	-21
(8) Taxes, Other Than Income	6,973	6,733	241
(9) Depreciation	26,934	21,570	5,364
(10) Income Taxes	13,591	8,596	4,996
TOTAL OPERATING EXPENSES	$93,158	81,818	$11,340

6.1. Purchased Power

The $36,000 test year difference in purchased power expenses between SJWC and DRA resulted from DRA imputing a five-year power costs previously incurred at the Columbine Station as an ongoing expense to be recovered from ratepayers. DRA imputed this additional purchased power costs as a result of its recommendation that the completed Columbine Station solar project be excluded from rate base. DRA's imputed purchased power adjustment is not reasonable and should not be adopted for the reasons addressed in a subsequent rate base Columbine pilot solar project discussion.

6.2. Recycled Water Retrofit

The $1,099,000 test year difference in recycled water expenses between SJWC and DRA resulted from SJWC including and DRA excluding conservation expenses for retrofitting recycled water landscape irrigation services. This cost is reasonable and should be adopted as a necessary cost to the proposed recycled water retrofit capital improvement projects being adopted in this decision, as addressed in a subsequent rate base recycled water mains discussion.

6.3. Uncollectible Revenue

The $35,000 test year difference in uncollectible revenue between SJWC and DRA resulted from SJWC and DRA applying the same uncollectible rate to different operating revenue estimates. SJWC and DRA both used a 0.002321% rate to calculate their individual uncollectible estimates. The 0.002321% uncollectible rate is reasonable and should be applied to operating revenue estimates being adopted in this proceeding.

6.4. Non-Tariff Services

The $24,000 test year difference in non-tariff services between SJWC and DRA resulted from the use of different forecasting methods for revenues received from non-tariff activities. SJWC used an inflation adjusted five-year historical average of revenues from non-tariff activities in forecasting ratepayers' test year revenue share of non-tariff activities at $432,000. DRA used $456,000, based on non-tariff contract revenues expected to be received in the test year. DRA's $456,000 forecast reasonably reflects the ratepayers' test year share of non-tariff revenues and should be adopted.

6.5. Other Operating and Maintenance

The $27,000 test year difference in Other Operating and Maintenance services between SJWC and DRA resulted from differences in applying the same

overhead rates to their respective direct operating and maintenance expense forecasts. The overhead rates used by SJWC and DRA are reasonable and should be applied to the direct operating and maintenance expenses being adopted in this decision.

6.6. Rent

The $333,000 test year difference in Rent between SJWC and DRA resulted from DRA imputing rent for SJWC's headquarters building in lieu of allowing that building in rate base. SJWC's lower $529,000 rent forecast is reasonable and should be adopted because the headquarters building has been included in rate base and no longer considered leased, as addressed in a subsequent Facilities Plan and Consolidation section of this decision. That rent expense should be increased by an additional $329,000 to reflect the cost of leasing the Bascom building as addressed in Section 7.8.2 of the Facilities Plan and Consolidation section, which was not reflected in the SJWC/DRA joint comparison exhibit.

6.7. Other Administration & General

The $21,000 test year difference in Other Administrative & General expenses between SJWC and DRA resulted from differences in applying the same overhead rates to their respective direct Administrative & General expense forecasts. The overhead rates used by SJWC and DRA are reasonable and should be applied to the direct Administrative & General expenses being adopted in this decision.

6.8. Taxes, Other Than Income

The $241,000 test year difference in Taxes, Other Than Income between SJWC and DRA resulted from applying the same .0118 property tax rate on different plant estimates as addressed in a subsequent rate base discussion.

6.9. Depreciation

The $5,364,000 test year difference in Depreciation expense between SJWC and DRA resulted from the use of different composite depreciation rates and different rate base estimates. SJWC used a 3.51% composite depreciation rate and DRA a 3.05% rate.[3]

SJWC used the Commission Division of Water and Audits' "Standard Practice for Determination of Straight-Line Remaining Life Depreciation Accruals," Standard Practice U-4, methodology for calculating its composite depreciation rate. SJWC, consistent with Standard Practice U-4, estimated its transmission and distribution (T&D) mains net salvage value from historical values, engineering judgment and forecasted future market conditions.[4] Specifically, SJWC derived a negative 80.8% net salvage rate based on 20 years of actual net removal costs, the current economic environment, and applied judgment.[5] In future proceedings, engineering studies that discuss the long depreciation timelines would be welcome.

Although DRA concurred with SJWC's use of Standard Practice U-4, DRA deviated from that standard practice in determining a net salvage value for SJWC's T&D mains because it was not convinced that SJWC's estimate was based on sufficient engineering judgment or future market conditions.[6] DRA

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[3] DRA revised a 3.01% composite depreciation rate it recommended in Exhibit 9 and testified to at hearing to 3.05% as detailed in Exhibit 25.

[4] Net salvage value for T&D mains is negative because those mains are typically abandoned in place and filled with concrete slurry. Reporter's Transcript Vol. 2, p. 172.

[5] Exhibit 5 at 4-1 and Reporters Transcript Vol. 2, pp. 168 and 169.

[6] Reporter's Transcript Vol. 4, p. 407.

applied a negative 40.0% net salvage rate proxy to arrive at its recommended composite depreciation rate. DRA obtained that proxy from a 2006 Depreciation Study of California Water Service Company, a water company providing water service in the same geographical areas as SJWC.[7]

DRA's net salvage value proxy for SJWC's T&D mains was based on a three-year-old depreciation study of a different water company having a large service territory made up of several small water systems with newer T&D mains substantially smaller than SJWC's T&D mains. SJWC, in comparison, provides water service to a large number of uses in a condensed area with mains up to 36 inches, some of which are in excess of 100 years old.[8] DRA's net salvage value proxy also ignored specific SJWC factors that DRA asserted were needed in determining when SJWC's mains should be replaced. These factors that impact salvage value include climate conditions, pipe material, soil corrosivity and soil stability.[9]

The Commission Division of Water and Audits' Standard Practice U-4, culled from direction and guidance given in Commission decisions, resolutions, and workshops, applies a uniform methodology to calculate depreciation reserves and expenses. Therefore, the results of a depreciation study using Standard Practice U-4 should be adopted absent evidence that the result from that uniform methodology is skewed.

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[7] Exhibit 9 at 9-3.

[8] Reporter's Transcript Vol. 2, pp. 164 and 165.

[9] Exhibit 9 at 8-51.

SJWC's 3.51% composite depreciation rate was based on that methodology, the same method used in its last rate proceeding.[10] DRA deviated from that uniform methodology by using one single component of another utility's depreciation study without substantiating that one component of another utility's depreciation study was a reasonable proxy for SJWC's T&D mains salvage rate. There is no evidence that the other utility's T&D mains are of comparable size, type, age, terrain, or depth as the T&D mains of SJWC. SJWC's 3.51% composite depreciation rate is reasonable and should be adopted.

6.10. Income Taxes

The $4,996,000 test year difference in Income Taxes between SJWC and DRA resulted from differences in forecasts of revenues, expenses, and rate base, with remaining differences from DRA's correcting an SJWC California Corporate Franchise Tax deduction to reflect changes in the California Revenue and Taxation Code effective for taxable years beginning on or after January 1, 2000.

Both SJWC and DRA used an 8.84% California Corporate Franchise Tax and a 35.00% Federal Income Tax rate to calculate their respective income tax estimates. The 8.84% California Corporate Franchise Tax and 35.00% Federal Income Tax rates are reasonable and should be applied to the operating revenues, operating expenses, and rate base estimates being adopted in this proceeding. The changes in the California Revenue and Taxation Code should be reflected, as DRA pointed out.

7. Rate Base

The $46,026,000 test year difference in rate base between SJWC and DRA resulted from the use of different capital forecasts of SJWC's (1) Solar

[10] Reporter's Transcript Vol. 2, p. 169 and Reporter's Transcript Vol. 4, p. 433.

Photovoltaic (Solar) Projects; (2) Hydro-Turbine Projects; (3) Montevina Station Project; (4) Recycled Water Mains Project; (5) Pipeline Replacement Program; (6) Meter Replacement Program; (7) Service Replacement; (8) Taylor Building; (9) Bascom Building; and (10) Depreciation Reserve. The differences between SJWC and DRA by rate base category and projects are summarized in the following table. A discussion of each difference follows the table.

	SJWC > DRA (Thousands of Dollars)	
	2010 Test Year	**Weighted Average**[11]
Plant In Service		
(1) Solar	$17,382	$
(2) Hydro-Turbine	647	
(3) Montevina	4,768	
(4) Recycled Water Mains	8,444	
(5) Pipeline Replacement	18,775	
(6) Meter Replacement	1,026	
(7) Service Replacement	922	
(8) Taylor Building	9,289	
(9) Bascom Building	4,457	
Total Plant in Service Difference	$65,710	$53,495
(10) Depreciation Reserve		- 7,469
TOTAL Rate Base Difference		**$46,026**

7.1. Solar Projects

SJWC proposed to construct and integrate into its operating system three solar projects at a total cost of $24,819,000 over this GRC cycle to complement its 2007 Columbine pilot solar project. DRA recommended that the $837,900 Columbine pilot solar project completed in 2007 be removed from rate base and that associated purchased power be imputed for that project. DRA also

[11] Weighted average is determined by adding to a beginning of year balance additions and retirements that would occur during the year based on a point in time when those additions and retirements would occur.

recommended that the three new solar projects not be approved. The test year 2010 difference was $17,382,000, for the Columbine plus 2009 and 2010 projects.

7.1.1. Columbine Pilot Solar Project

SJWC undertook its $838,000 Columbine pilot solar project for two reasons: (1) to evaluate the feasibility of large-scale solar systems and (2) the year 2007 was the final opportunity to apply and receive $191,000 in rebates from the Pacific Gas and Electric Company Self Generation Incentive Program.[12] This November 2007 solar pilot project is monitored by a third party for the first five years of solar operations, as required by Pacific Gas and Electric Company (PG&E).[13]

A 2008 field test by SJWC's contractor found that the project performed at a level that would produce 121,377 kilowatt-hours (kWh) annually, 8,586 kWh above the 112,791 kWh designed production.[14] However the actual 2008 performance of this solar project was 10% below designed production. SJWC attributed this performance deficiency to: (1) more cloudy days in 2008 than average; (2) a learning curve on how often the solar panel arrays needed to be cleaned; and, (3) failure of two inverters which caused several days of down-time.[15]

SJWC did not provide sufficient information to substantiate that the "pilot" designation of this project should be reclassified to an efficient ongoing

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[12] Exhibit 5 at 3-18.

[13] Exhibit 13.

[14] Reporter's Transcript Vol. 2, p. 131 and p. 137.

[15] Exhibit 5 at 3-18.

project. Although SJWC obtained a working knowledge of this project during its first year's operation regarding weather, panel arrays, and failure of inverters, there is insufficient information in the record to assess the project's operational performance as a result of SJWC's actions to overcome these obstacles. For example, SJWC *predicted* that it should clean the solar panels two times during the year to keep the efficiency up.[16] However, the result of that prediction has yet to be placed into evidence. This project should continue as a pilot project in rate base so that SJWC can gather operational performance data to determine whether the pilot project matches expectations and benefits ratepayers.

7.1.2. New Solar Projects

The first new solar project involves a 600 kW photovoltaic (PV) solar system at Williams Station #1 costing $8,150,000. The second solar project, also a 600 kW PV system, would be at Williams Station #2 costing $8,394,000, and the third solar project, an 800 kW PV system would be at Twelfth Street Station costing $8,275,000.[17]

SJWC proposed these solar projects to increase its operational efficiency and flexibility, to promote environmental stewardship and to be responsive to California's goal to significantly reduce greenhouse gas (primarily carbon dioxide) emissions. It explained that these projects have a 30-year life expectancy with limited need for maintenance, contribute toward stabilizing the electric grid on high-demand days, and provide SJWC operational flexibility for running well

[16] Reporter's Transcript Vol. 2, p. 138.

[17] Project costs were adjusted to reflect agreed upon inflation factors.

and booster pumps during summer on-peak hours when reserves are low on the state's electric power grid.[18]

SJWC also identified numerous direct and indirect benefits from its solar (green energy) projects to its ratepayers who are also ratepayers of PG&E. For example, renewable energy would: (1) feed directly into the urban electric grid without transmission; (2) bolster reliability and reduce stress on the electrical grid by generation during on-peak hours; (3) lower PG&E's production cost when SJWC generates energy; and, (4) offset the need for PG&E to construct new power stations and peaking generators.[19]

To further bolster support for these projects, SJWC also referenced the Governor's Executive Order S-14-08, which mandates that 33% of all electricity consumed in the state be generated from renewable energy sources by 2020, and the state's renewable portfolio standard (RPS) to reduce greenhouse gases to levels measured in 1990 by the year 2020. SJWC also noted the commitment of Mayor Chuck Reed and the San Jose City Council to generate 100% of all power consumed within the city from renewable sources by 2022.

SJWC provided net present value (NPV) calculations for the three solar projects indicating that the projects would provide positive net benefits by the fourth year of operation for the Twelfth Street Station project and by the tenth year for the Williams projects.

DRA also provided NPV calculations for the three solar projects. Contrary to SJWC's positive results, DRA's results showed that none of the three solar projects would attain a positive NPV during their 30-year life span. According to

[18] Exhibit 3.

[19] Exhibit 5 at 3-19.

DRA, the Twelfth Street Station project would have a negative $1.3 million NPV at the end of a 30-year period, Williams Road #1 a negative $3.4 million, and Williams Road #2 a negative $1.4 million.[20]

The largest difference between the company's NPV analysis and that of DRA lies with whether or not the ratepayer perspective ought to be considered.[21] Other differences between SJWC and DRA were in the amount of energy production that would be sold back to PG&E, the escalation of energy prices, the value of Renewable Energy Credits, and the benefits that would flow to SJWC's ratepayers. DRA was generally opposed to allowing the regulated water utilities to develop renewable energy projects and opined that public agencies are in a better position to construct economically viable projects.

Although SJWC compared types of solar projects such as roof mounted solar projects, it did not undertake a least-cost energy efficiency comparison.[22] Before the Commission endorses such a large capital investment in solar projects, this and other analysis ought to take place.

Not only that, the presumed energy performance of the three proposed solar projects was based on extrapolating designed performance from the Columbine pilot solar project. Added to those results were improvements in the solar technology since the Columbine solar project became operational.[23]

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[20] Exhibit 9 at 8-10.

[21] DRA treats the annual earning for each renewable energy project as a penalty in the NPV model. DRA included a 10.13% return on equity as the cost of money. DRA uses a net-to-gross multiplier in the NPV calculation.

[22] Reporter's Transcript Vol. 2, p. 158.

[23] Reporter's Transcript Vol. 2, p. 159.

However, SJWC has yet to substantiate that the Columbine pilot project can meet or exceed its designed performance. For such a large investment and because solar development is still in the nascent stage for our regulated water companies, we need more time with the pilot project currently in operation and more time than is allowed in this proceeding to vet the pros and cons of these proposals. Perhaps a joint application with PG&E or another joint venture partner or partners could be made. Conceivably, a "procurement review group" type gathering might be helpful in looking at alternatives and assumptions. If other water utilities wish to embrace renewable projects on a large scale, an industry-wide approach might also be considered.

SJWC is correct to ask the Commission to make a policy decision with regard to the development of renewable energy projects for water companies. The nexus between water and energy is of great interest to the Commission and the state of California. We have affirmed this in our support of pilot programs. But there is still much to learn from pilots before we approve such large capital projects with yet to-be-proven benefits.

The large differences in the NPV calculations between SJWC and DRA do not add confidence for these projects, or the expected performance of these projects. SJWC should be commended for taking the initiative in proposing solar projects. However, there is insufficient reliable data available to assess benefits that would flow to SJWC's ratepayers during this current economic environment or whether the projects would improve SJWC's ability to provide quality and reliable water service. The solar projects proposed for this test year cycle should not be adopted at this time. As such, we give greater weight to capital investments in water supply and reliability for this GRC cycle.

7.2. Hydro-Turbine Projects

SJWC also proposed to construct and integrate into its operating system three hydro-turbine projects, one each year, at a total cost of $2,016,000.[24] The first project involves a 72 kW system at Cox Avenue Station (Cox) costing $701,400. SJWC proposed to run the Cox project as a pilot project because it currently has no hydro-turbines in service.[25] The second project involves a 67 kW system at Alum Rock Turnout #1 (Alum Rock) costing $647,000 and the third project involves a 100 kW project at Morrill and Hostetter Turnout #2 (Hostetter) costing $667,000. DRA concurred with SJWC that the Cox project should be undertaken as a pilot project but recommended that the Alum Rock and Hostetter projects not be allowed.

SJWC described similar benefits for its hydro-turbine projects as identified in the prior solar projects discussion. Although the benefits to be derived from these projects are of smaller scale in terms of capacity and cost, SJWC represented the benefits will last longer because they each have a 40-year life expectancy. SJWC also provided NPV calculations to show that positive net benefits would be provided by the Cox project after three years, Hostetter after five years, and Alum Rock after seven years.

DRA also provided NPV calculations for each of the hydro-turbine projects. However, DRA concluded from its calculations that the Cox and Hostetter projects would not show a positive NPV until after 30 years of operations while the Alum Rock project would continue to show a negative

[24] Hydro-turbines are impellers that generate electrical energy due to the hydraulic flow within a main.

[25] Exhibit 3, SJWC CIP Index #3701.

NPV.[26] DRA was not able to obtain any operational performance data from SJWC to verify the reasonableness of SJWC's annual power production forecasts.

DRA concurred with SJWC that the Cox project should be approved as a pilot project, but recommended the pilot project cover a two-year period in order to determine if the performance of the unit matches expectations due to an uncertainty of the pilot project's field performance and lack of any operational performance data.[27] DRA recommended that funding for the remaining two hydro-turbine projects should be denied.

Cox has a number of pumps with time of use metering systems that enable SJWC to participate in a net energy metering price for power produced by a hydro-turbine installed system at that location. This hydro-turbine project would directly benefit SJWC and its ratepayers by enabling SJWC to use its own produced energy to run its Cox facilities. The project will also assist SJWC in providing reliable water service to its ratepayers during peak purchased power demands, curtailments and revolving outages, while reducing its purchased power needs.

Although SJWC intends to conduct a detailed analysis of hydro-turbine performance prior to ordering the equipment, it did not substantiate that actual performance would match performance expectations.[28] This approach does not give enough assurance. Therefore, consistent with DRA's proposal, the Cox hydro-turbine project should be undertaken as a two-year pilot project.

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[26] Exhibit 9 at 8-12.

[27] *Id*. at 8-13 and 8-14.

[28] Exhibit 5 at 3-20.

Unlike the Cox project, the Alum Rock and Hostetter projects would not provide a direct benefit to SJWC and its ratepayers. Neither Alum Rock nor Hostetter has wells or pumps at their locations. Therefore, any power generated at these locations must be sold back to PG&E under a power purchase agreement.[29] Indirect benefits would result because these projects would improve PG&E's energy reliability during peak demand times, reduce SJWC's carbon footprint, and reduce SJWC's operating expenses with any revenues received from selling power generated from these projects. These kinds of projects ought to be considered in a joint application with PG&E or another joint venture partner or partners.

SJWC is in the business of providing quality and reliable water service to its ratepayers and not in the business producing and marketing power. Therefore, hydro-turbine projects that directly benefit SJWC and its ratepayers in providing quality and reliable water service while reducing its purchased power consumption should be given priority over hydro-turbine projects that do not. The Alum Rock and Hostetter hydro-turbine projects should not be approved at this time. SJWC is encouraged to propose additional hydro-turbine projects that meet this criterion in its next GRC.

7.3. Montevina Station Project

The $4,768,000 test year difference in Montevina Station project costs between SJWC and DRA resulted from a difference on need for this four-year project to meet new water quality standards. This difference consists of $206,000 applicable to a 2009 facilities plan study and $4,562,000 for test year environmental, pilot testing, and detailed design and specifications. SJWC

[29] Exhibit 9 at 8-12 and 8-13.

forecasted an additional $7,648,000 in 2011 to implement a water treatment process to meet water quality regulations.

SJWC proposed this project to upgrade its Montevina Station water treatment facility that treats surface water flows from the Los Gatos Creek watershed for delivery into SJWC's distribution system. The upgraded project was proposed to comply with new water quality standards. Effective January 2008, stricter standards on individual filter effluent turbidity were imposed as part of the Interim Enhanced Surface Water Treatment Rule (IESWTR). Effective April 2012, water sample points are expected to change to comply with an updated State 2 Disinfectants and Disinfection Byproducts Rule (DBP2).

Most of SJWC's surface water comes from the Montevina Station during the winter months, which takes water from intakes on the Los Gatos Creek and its tributaries. However, this water has been subject to rapid changes in turbidity, making it difficult to comply with current and new water quality filtration rules in treating high turbidity water. For example, SJWC was cited by the California Department of Public Health in January and February of 2008 for exceeding IESWTR operating criteria at the Montevina Station. Corrective action to comply with IESWTR required SJWC to reduce the amount of raw water that could be treated at Montevina Station to 15 Nephelometric Turbidity Units, resulting in decreased production of 1,243 acre feet in an average rain year due to turbidity.[30] That reduction in filtering surface water limited SJWC's surface

[30] Nephelometric Turbidity Unit (NTU) is a unit measurement of a lack of clarity of water. Water containing one milligram of finely divided silica per liter has a turbidity of one NTU.

water production and had a potential effect of reducing SJWC's water rights at these intakes.[31]

The DBP2 rule would regulate disinfection byproduct concentrations at specific locations in the distribution system rather than at a system wide average. SJWC's preliminary results indicate that Montevina Station effluent would not comply with these standards for total Trihalomethane.[32]

SJWC has shown that it has lost surface water supplies from the Los Gatos Creek and its tributaries due to high turbidity and that it could suffer additional surface water losses due to its potential inability to satisfy new water quality standards. Although this loss of surface water could be made up from the purchase of additional water from other sources, such as the Santa Clara Valley Water District, there is no assurance that replacement water sources would be available, or at what cost.[33]

SJWC has substantiated a need to plan for a Montevina Station upgrade project to maintain water quality and to maintain, if not increase, local senior water rights and supply through surface water treatment.[34] To the extent that SJWC is able to increase its water supply at Montevina Station, which uses less energy than pumping groundwater from the valley below, SJWC would be in a better position to meet the Commission's Water Action Plan's mandate that

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[31] Exhibit 2 at 16-7 through 16-9 and Exhibit 5 at 3-24.

[32] *Id*. at 16-8.

[33] Exhibit 5 at 3-25 and 3-26.

[34] Exhibit 2 at 16-8 and 16-9.

Class A water utilities reduce their energy consumption by 10 percent over a three-year period.[35]

As of its January GRC filing date, SJWC was preparing a contract for the planning study with a selected consultant to evaluate and recommend a technology to satisfy future regulatory compliance and to consider technologies for treating waters of various turbidity levels at Montevina Station.[36]

The $209,000 forecasted facilities plan study is reasonable and should be approved. With the Montevina Station project being at an early stage of planning, the remaining project costs should not be approved until a facilities plan study has been completed and a specific project design has been established. SJWC should file a separate application outside of this GRC seeking approval of its project costs and recovery for upgrading its Montevina Station to maintain water quality and to increase its capacity to treat surface water upon completion of a facilities plan study and specific project design.

7.4. Recycled Water Mains

The $8,444,000 test year difference in recycled water mains expenses between SJWC and DRA resulted from a difference in how recycled water mains projects should be funded. SJWC proposed using ratepayer funding. DRA concurred with SJWC on a need to expand its recycled water facilities. However, DRA opposed any funding for these projects because SJWC had not done enough to pursue partners or public financing for these capital projects.[37] DRA

[35] Reporter's Transcript Vol. 4, p. 323 and Exhibit 5 at 3-13.

[36] Exhibit 2 at 16-8 and 16-9.

[37] Exhibit 9 at 8-31.

recommended that SJWC establish partnerships with other public agencies, such as the City of San Jose, in seeking and applying for public grants and tax exempt funding before requesting rate recovery for unfunded portions of these recycled water projects.

By way of background, SJWC purchases recycled water through a South Bay Water Recycling Program (SBWR), which currently delivers approximately 10,000 acre-feet/year (AFY) of its 50,000 AFY capacity to San Jose and other South Bay cities. SJWC has proposed three recycled water projects, one for each year of its GRC cycle. These projects were designed to serve identified users of recycled water for irrigation purposes and, in the long-term, groundwater recharging.

The first year project undertaken in 2009 would cover approximately 7,600 feet of mains in partnership with a developer. The developer would pay approximately $900,000 for an 8-inch pipeline and SJWC approximately $1,665,000 to increase that pipeline to 24 inches. The second year project would involve 21,000 feet of mains at a cost of $6,779,000 and the third year project 10,300 feet of mains at $6,979,000.[38] The latter two projects would be funded entirely by ratepayers.

Recycled water has become a viable and reliable alternative to offset potable water demands for irrigation and industrial use as well as for stream flow augmentation, including groundwater recharge. As noted by DRA, SJWC is but one of many Santa Clara Valley recycled water partners participating in SBWR. SJWC's proposed recycled water projects would benefit not only its

[38] *Id*. at 8-27 and Exhibit 20, 2009 at p. 6, 2010 at p. 4, and 2011 at p. 3. Project costs were adjusted to reflect 3.0% agreed upon escalation factor.

ratepayers but each of the Santa Clara Valley recycled water partners by SJWC contributing to maintain and extend existing potable water supplies in the entire Santa Clara Valley Region. Therefore, it is reasonable to expect SJWC to enter into partnerships for these and other recycled water projects.

SJWC had sought out partners for these projects prior to filing its GRC with limited success; one developer agreed to share in the cost of the first of three projects. However, SJWC has continued to seek cost sharing partners.[39]

We concur with DRA that SJWC should have been more pro-active in seeking partners and external funding sources for these projects. However, we recognize that it is difficult to pursue such partners and funding without an approved shovel ready project. For example, SJWC must substantiate that it has matching funds to cover at least half of project costs to obtain funding from the U.S. Bureau of Reclamation or from the State Clean Water State Revolving Fund.[40] Further, completion of a funding application would not assure funding, let alone immediate receipt of any approved funding. Also, the U.S. Bureau of Reclamation funding process takes up to three years.[41]

The recycled water projects are reasonable and should be approved. However, SJWC should not be relieved of seeking partners to share in its reclaimed water projects or of seeking public grants and funding. While we considered the benefit of approving half of the dollar amounts as an incentive for pursuing partnerships, we weighed that against the true value of adding recycled water infrastructure in the state. Any partnership, public grant, and

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[39] Exhibit 5 at 3-34 to 3-38.

[40] *Id*. at 3-35 and 3-36.

[41] *Id*. at 3-38.

funding that SJWC receives for its water recycled projects should be credited to ratepayers as Contribution in Aid of Construction upon receipt. SJWC is on notice that as part of its next GRC application it should substantiate the process and results of the process it undertook to obtain partners to share in the costs and to obtain and receive public grant and tax exempt funding for its reclaimed water projects. We expect SJWC to make all efforts big and small to mitigate the costs.

7.5. Pipeline Replacement Program

The $18,775,000 test year difference in the Pipeline Replacement Program between SJWC and DRA resulted from SJWC seeking to increase its 0.5% baseline replacement rate of 13 miles per year by 4 miles per year with a goal of achieving a 1.0% replacement rate per year by 2011. SJWC proposed to spend $110,222,500 to attain its goal of replacing 1.0% of its 2,380 miles of pipe annually by the end of this GRC cycle.[42] DRA recommended $66,278,500 over the same period based on its review of individual projects proposed by SJWC.[43] SJWC's 1.0% annual pipeline replacement goal of its 2,380 miles of pipe results in an average pipe life expectancy of 100 years while DRA's recommendation of approximately 0.5% per year equates to an average pipe life expectancy of 200 years.

SJWC based its increased replacement goal on three pipeline infrastructure studies completed in 2003, 2004, and 2008.[44] The 2003 study employed a

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[42] Exhibit 7, 2008 Study at 3. Project costs are prior to adjustment for 3.0% agreed upon escalation factor.

[43] Exhibit 9 at 8-68. Project costs are prior to adjustment for 3.0% agreed upon escalation factor.

[44] Exhibit 7.

"KANEW" model, a pipe replacement model distributed by the American Water Works Association Research Foundation. This program used survivor curves based on actual pipe failure and replacement data of the particular utility using the program. This model predicts a replacement rate based on the material of pipe in the system, age of pipelines, estimated average age at failure, estimated minimum age of rehabilitation or replacement, and estimated high age of failure.[45] The 2004 study undertook a more micro level KANEW look at which pipes should be replaced including an estimated order of priority based on pipes with: (1) numerous leaks; (2) less than 10 years of remaining life; (3) any leaks; and, (4) inadequate fire flow. The 2008 study built on the prior two studies employed a point system to prioritize the top 500 pipes needing replacement. That study also found that SJWC was falling behind in its replacement program by 15 miles of pipe annually over the last four years and that it needed to ramp up the number of replacement miles annually.

DRA rejected SJWC's 1.0% replacement goal that was based on the KANEW model. This is because the KANEW model does not reflect that pipelines' life can be extended through regular maintenance and repair, it is difficult to verify model results, and the model fails to focus on major factors that influence the aging process such as material, joints, diameter, bedding, environmental conditions, soil corrosivity, stray electrical currents, and soil stability.[46]

Irrespective of DRA's misgivings of relying on the KANEW model results, DRA used the 2008 Study's top 500 replacement list as a base for its forecast.

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[45] *Id.*, 2003 Study at 1.

[46] Exhibit 9 at 8-51.

DRA compared each of the 244 projects that made up SJWC's GRC forecast to the list and excluded all projects that: (1) were not on that replacement list; (2) had no leaks in the last 10 years; or, (3) were upsized projects to meet additional fire flow of more than 1000 gallons per minute at a residential pressure of 20 pounds per square inch.[47]

SJWC does not dispute DRA's contention that repairing leaks is less expensive than replacing piping. However, SJWC's water system, dating back to 1866, has piping up to 140 years old. Due to the many types of piping in SJWC's water system, some of the most common steel and cast iron pipe types are nearing or exceeding their useful lives at the same time. SJWC has approximately 230 miles of cast iron pipe with an average age of 75 years, of which 50 miles are over 100 years old. It also has 1,150 miles of steel pipe at an average age of 50 years, of which 20 miles are over 80 years old. The old cast iron pipe up to 130 years old has an average life expectancy of approximately 110 years and the younger thin walled steel pipe has an average life expectancy in the 80 to 85-year range.[48] The pipes listed in the 2008 Study's top 500 list, some of which are more than 120 years old, averaged 64.4 years in comparison to SJWC's total system average of 36.8 years.[49]

SJWC has managed its aging pipe system well and the ratepayers have benefitted through lower rates. All leaks since 2003 cost $6,600,000; business damages since 2002 were approximately $96,999; and the leaks resulted in no reportable injuries, contamination or environmental impacts over the past

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[47] *Id*. at 8-57.

[48] Exhibit 5 at 3-39 to 3-42 and Exhibit 7, 2003 Study, Appendix D.

[49] Exhibit 7, 2008 Study at 18 and Appendix A.

10 years.[50] This is a remarkable track record and ought to be commended. But there is a limited amount of maintenance and repair that can be done on aging pipe to extend its life. It would be imprudent for SJWC to defer pipe replacement in favor of waiting for leaks to occur in its aging pipe system. And it is unreasonable for DRA to place a bet on pipeline failure. The reactive approach has historically kept rates low, but the analysis does not capture the negative future effect of catastrophic failures of neglected pipe. The time has come for us to become more proactive about infrastructure, and in particular, avoiding pipeline failures. We are encouraged by and cautious about SJWC ambitious schedule.

To ensure that SJWC's ratepayers continue to receive reliable and quality water service and given the current age of SJWC's pipes, it is reasonable and appropriate to adopt SJWC's Pipeline Replacement Program for this test year cycle. While SJWC's proposal is aggressive, it is not obscene. We expect a full accounting of the findings and success of the accelerated replacement program as part of its next GRC.

7.6. Meter Replacement Program

The $1,026,000 test year difference in the meter replacement program between SJWC and DRA resulted from a difference regarding whether SJWC had a surplus of 1" and smaller meters in inventory. SJWC forecasted $948,000 for 2009, $1,007,000 in the test year, and $1,127,000 in the subsequent year. DRA forecasted $464,000 for each of the three years, based on a simple average of SJWC's actual 1" and smaller meters purchased and installed in the five-year period from 2004 to 2008.

[50] Exhibit 9 at 8-49.

SJWC's forecast consisted of two components. The primary component of its forecast is to replace meters that have reached the end of their useful life. A minor component of the program is to meet a modest system growth. SJWC contended that its meter replacement program was based on the *guidelines* set forth in the Commission's General Order 103.[51]

SJWC's actual 1" and smaller meter replacement program in 2007 and 2008 did not meet its budgeted meter replacement goal because its personnel assigned to routinely replace those smaller meters were redirected to implement an Automated Meter Reading Program that involved the retrofit of 5,200 large size meters during that time period. As a result of this redirection, SJWC fell behind replacing its small meters. SJWC contended that its personnel are now back on track to complete both the meters scheduled for replacement in 2009, as well as its backlog from previous years.[52] However, SJWC provided no information on how long the meters budgeted for replacement but not replaced in 2007 and 2008 and forecasted to be replaced during this GRC cycle have been in service.

General Order 103 sets forth *rules*, not *guidelines* as apparently interpreted by SJWC in establishing its meter replacement program, prescribing minimum standards for water utilities to follow. Section VI.6 of that General Order, which does not establish specific periods to test the accuracy of small meters, precludes SJWC from keeping meters smaller than 1" in service for more than 20 years and

[51] Exhibit 5 at 3-5 and 3-6.

[52] Exhibit 5 at 3-6.

1" meters in service for more than 15 years without being pulled, tested, or replaced.[53]

DRA's meter forecast based on an average of actual meter replacements is reasonable and should be adopted. SJWC should provide a written report to the Director of the Division of Water and Audits explaining its 2007 and 2008 small meter backlog and whether that backlog resulted in a General Order 103 violation. SJWC should also address in its written meter report whether our adoption of DRA's meter replacement forecast will preclude SJWC from complying with General Order 103-A. If SJWC was in violation of General Order 103 or will be in violation of General Order 103-A, SJWC should file a new application separate from this proceeding explaining the circumstances of its possible violation or violations and proposing a solution to bring it into conformance.

7.7. Service Replacement Project

SJWC forecasted $3,236,000 for service replacements for the year 2009, $4,117,000 in the test year, and $5,047,000 in the second year of the GRC cycle. DRA forecasted $3,200,000 for the year 2009, $3,231,000 in the test year, and $3,305,000 in the second year of the GRC cycle. These service replacements are directly related to pipeline replacements.

The $922,000 test year difference in the service replacement project between SJWC and DRA mainly resulted from a difference in their assumptions regarding how much pipeline would be approved for replacement in this

[53] Although General Order 103-A superseded General Order 103 pursuant to D.09-09-004 and the Section pertaining to the test of water meters was moved to Section IV.6 from Section VI.6, the maximum time period for keeping meters in service without testing remained the same.

proceeding. The forecasted service replacement program of SJWC is consistent with the pipeline replacement program being adopted in this proceeding and should be adopted.

7.8. Facilities Building Consolidation

In 2006, SJWC updated its 1998 Strategic Facilities Plan that, among other matters, evaluated a consolidation of operational functions and alternatives to mitigate inefficiencies at its Main Office building, a historical landmark. A consultant was retained by SJWC to analyze alternative space scenarios and to compare the capital outlay and NPV of each scenario to identify the most economically efficient alternative. The consultant issued a 2006 report that identified three most viable alternatives for consolidation of SJWC's operations and staff.

A base case scenario that involved remodeling the Main Office Building was deemed not feasible because of the historical designation of the Main Office building.[54] The first alternative scenario proposed to sell the Main Office, relocate employees to a non-designated downtown San Jose building under a lease, and lease an additional 10,000 square feet of first floor space at 1265 South Bascom Avenue (Bascom building), where it already leases the 10,800 square foot second floor.[55] Two other existing buildings were to undergo remodeling. The second alternative differed from the first only to the extent that a new office in downtown San Jose and the Bascom building would be purchased instead of being leased.

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[54] D.08-10-018 (2008), *mimeo.* at 65.

[55] An allowance for remodeling each building was included in each scenario.

On January 22, 2007, SJWC filed an application for approval to sell the Main Office under Section 851 of the Public Utilities Code and for authorization of the investment of sale proceeds under Section 790. SJWC included the consultant's analysis of alternatives to show the process it used to make a choice so that the Commission could review the reasonableness of SJWC's Alternative 2 selection as being most economical. Between the dates SJWC filed its application to sell the Main Office and a decision on that proceeding was issued, SJWC purchased two replacement buildings.

SJWC was authorized by D.08-10-018 to sell its prior headquarters building. SJWC was also authorized a rate increase based on an expected costs of leasing replacement buildings under the first alternative. Because the application did not seek authority to purchase replacement buildings, SJWC was authorized to track costs of owning and renovating a new Main Office at 110 West Taylor Street (Taylor building) and the Bascom building in a memorandum account for possible rate base recovery in this GRC.[56]

7.8.1. Taylor Building

SJWC purchased the Taylor building in November of 2007, 10 months after SJWC filed its application for authority to sell its Main Office, at a cost of $6.9 million. Renovations totaling $5.3 million were made to that facility. DRA opposed SJWC's request to include any of the $6.9 million purchase price and $2.4 million of the $5.3 million renovation costs in rate base because a lease option was the least cost alternative to purchasing a new Main Office building and the 28,000 square foot Taylor building substantially exceeded the

[56] D.08-10-018 (2008), *mimeo.* at 84 and 85.

15,180 square foot space requirement included in the consultant study for a new main office building.[57]

SJWC searched for an appropriate Main Office replacement building to be leased or purchased between mid-2006 and mid-2007, starting approximately six months prior to filing its application to sell the Main Office building and concluding six months after the application was filed. The criteria used by SJWC required that the building must, at a minimum, (1) be a free-standing building between 15,000 and 20,000 square feet; (2) have adequate, safe, secure and well-lit off-street parking; (3) be in a central location within its service area; (4) be in close proximity to public transportation; and, (5) satisfy American Disabilities Act accessibility requirements.[58]

That search found only eight buildings that met at least some of its minimum criteria for replacement buildings in the downtown San Jose area. Six buildings were available for purchase and two for lease. However, only the Taylor property available for purchase met all of the minimum search criteria.[59] Therefore, SJWC purchased the Taylor building for its new Main Office.

The only flaw in the Taylor building was that it had 28,000 square feet of floor space, 12,200 square feet in excess of the 15,800 square feet needed to replace the old Main Office, as identified in SJWC's consultant study.[60] In

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[57] DRA allowed $2.9 million, or 54%, of Taylor building remodeling costs based on a percentage difference between 15,169 square feet of main office replacement space and the total 28,000 square feet of Taylor building space.

[58] Exhibit 2 at 21-2.

[59] Exhibit 5 at 3-54.

[60] Exhibit 2 at 21-4.

regards to excess space, SJWC explained that the consultant's study excluded square footage allowance for stairwells or elevators for a multi-level stand-alone building such as the Taylor building, which has 2,100 square feet dedicated for these elements.[61] DRA acknowledged that these areas were not addressed in the consultant's study.[62] SJWC subsequently allocated additional square footage of that excess space for storage, mail handling, customer and visitor reception, and a training facility. The employee break room and board room areas were also expanded beyond the consultant study to save on remodeling costs by keeping rather than moving some existing walls in the Taylor building.[63]

SJWC purchased the Taylor building knowing that it offered more space than needed based on the consultant's study. The lease alternative adopted by D.08-10-018 for a new Main Office was based on square footage needed to replicate and upgrade the old Main Office space based on average market values in the San Jose area at that time, not based on actual replacement buildings available at that time.

SJWC's decision to purchase the Taylor building must be evaluated for reasonableness at the time the purchase was made. SJWC had the benefit of a consultant study for its needs. However, that study was more than a year old and not based on any specific buildings available to replace the Main Office. SJWC applied the results of that study to its criterion for evaluating a specific Main Office replacement, whether lease or purchase. Unfortunately, only the Taylor building met all of its basic criteria for relocating its Main Office. DRA

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[61] *Id.*

[62] Exhibit 9 at 8-81.

[63] Exhibit 5 at 3-56.

was not aware of whether a comparable Main Office building was available for lease at the time.[64]

Floor space should not be the sole criterion for determining whether SJWC should lease instead of purchasing a building. Factors such as building location, safety, security, access for disabled persons, and ability to upgrade the building's systems and infrastructure are necessary attributes to ensure adequate facilities. The process SJWC used to locate a Main Office replacement included all of the above factors and was appropriate and reasonable. SJWC's purchase of the Taylor building and all of its related remodeling costs were reasonable and should be included in rate base.

7.8.2. Bascom Building

SJWC purchased the Bascom building in May of 2007 for $4.5 million and invested $1.5 million to remodel portions of the 21,800 square foot building for utility use. Remodeled portions of the building were placed into service on December 26, 2007. DRA opposed SJWC's request to include the Bascom building purchase price in rate base because D.08-10-018 found that a lease option was the least cost alternative to purchasing the building. DRA concurred with SJWC that the costs to remodel the Bascom building were reasonable and should be included in rate base.

The Bascom building is a two-story building. The first floor has 10,000 square feet of space and the second floor 11,800 square feet. SJWC's Engineer and Construction Department has occupied the entire second floor under a lease agreement since 1999.[65] Upon purchase of the Bascom building,

[64] Reporter's Transcript Vol. 4, p. 419.

[65] Exhibit 2 at 21-5.

SJWC relocated some of its employees to the Bascom building's 10,000 square foot first floor. Its construction department located on the second floor moved to the first floor. The Human Resources Department, Customer Service Call Center, and some Information Technology support positions were relocated to the first floor from the old Main Office.[66] Now, the entire building is occupied by SJWC personnel.

In the decision that authorized SJWC to sell its Main Office building, we recognized that SJWC had already purchased the Bascom building and that SJWC does not need Commission approval to purchase property. However, to the extent that SJWC chooses to purchase property for public utility use before recovery of the costs in connection with the purchase is approved by the Commission, it does so at its own risk. In the case of the Bascom building, we approved a revenue requirement based on leasing the building because the cost of leasing the Bascom building was less than the cost of purchasing that specific building.[67]

SJWC asserted that, at this time, the total building is necessary and useful for utility operations and should be included in rate base. DRA did not dispute the building's necessity and usefulness. DRA disputed the placing of a building into rate base that has been partially leased for the past 10 years by SJWC and based on D.08-10-018's least cost analysis that showed leasing the additional 10,000 square feet of first floor space was the least cost alternative to ratepayers in comparison to purchasing the same building.

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[66] Reporter's Transcript Vol. 3, p. 301.

[67] D.08-10-018 (2008), *mimeo.* at 66.

There is no evidence in this record to support or justify changing D.08-10-018's conclusion that the least cost benefit to SJWC ratepayers was for SJWC to lease, not purchase, the Bascom building. Therefore, the Bascom building purchase price should be excluded from rate base. Only the remodeling costs should be included in rate base. However, SJWC should be allowed the cost of leasing the Bascom building as an operating expense, as calculated by DRA.

7.9. Depreciation Reserve

The test year difference in depreciation reserve between SJWC and DRA resulted from their use of different test year plant additions and different net salvage value for T&D mains. Plant estimates and depreciation rates adopted in this order should be used to derive the test year depreciation reserve.

8. Fluoridation Costs

SJWC requested a memorandum account for costs related to fluoridation activities. DRA opposed SJWC's request on the basis that the request is premature and does not meet the Commission's conditions for establishing a memorandum account.[68]

California Health and Safety Code Section 116415 requires a water utility to implement fluoridation into its water system if third party funding is available to cover the capital costs and the first year's operations.

SJWC requested authority to establish a fluoridation memorandum account because it was approached by an organization named Health Trust that set a goal to fund all the initial capital costs of implementing fluoridation into

[68] Exhibit 9 at 15-1.

SJWC's water system plus the first year's operating and maintenance costs, and associated operations.[69]

To date, Health Trust is in a fundraising mode and has yet to commit funding for the capital improvements and first year's associated operations. The first part of Health Trust fundraising activities is to raise sufficient funds for a cost study to determine what the actual cost may be.[70] SJWC does not know what the cost would be but believes it to be significant.[71]

Once Health Trust raises sufficient funds for all the capital improvements and first year's associated operations and guarantees those funds to SJWC, SJWC must implement fluoridation into its water system within two years.[72] However, if Health Trust is unable to raise and guarantee sufficient funds for the capital improvements plus first year's associated operations, SJWC would be exempt from fluoridating its water system.[73]

SJWC, from an operations standpoint, expects to begin fluoridation within the next two years and have a *potential* shortfall in associated operations costs for which it would be liable in the third year of this GRC cycle.[74] Regardless of when fluoridation begins, the California Health and Safety Code requires this Commission to approve rate increases for a public utility water system within

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[69] Reporter's Transcript Vol. 6, p. 506.

[70] *Id*.

[71] *Id*. at p. 503 and p. 506.

[72] *Id*. at p. 507.

[73] *Id*. at p. 506.

[74] *Id*. at p. 508.

45 days of the filing of an application or advice letter in accordance with our requirements showing in reasonable detail the amount of additional revenue required to recover fluoridation associated costs.[75] The authorization of a memorandum account would not meet this requirement as the establishment of a memorandum account does not increase rates, but only allows for a possible increase sometime thereafter. Accordingly, to meet the requirements of this provision of the Health and Safety Code, this Commission should establish a mechanism to allow for a prompt rate increase within the time frame contemplated by that statute. There should be no need for such a rate increase during the first year of the operation of the fluoridation system, as those costs are expected to be covered by the Health Trust or another outside party. Therefore we will authorize SJWC to file a Tier 2 advice letter to establish rates to recover the incremental O&M costs incurred in operating the fluoridation system beyond the first year, if sufficient funds are guaranteed to SJWC for the capital improvements plus the costs of the first year's operation. This advice letter should be filed no earlier than 90 days before the end of the first year of operation. The rates requested should be based on the actual recorded costs of operation, and subject to refund if those costs are found to be unreasonable. In addition, the advice letter should explain why the costs whose recovery is requested are incremental, and not already included in rates.

9. Affiliated Company Activities

DRA took issue with some affiliated company activities that do not impact SJWC's test year. These activities were sales of utility property and non-tariff activities.

[75] California Health and Safety Code Section 116415(h).

9.1. Utility Property Sales

DRA recommended that SJWC should be required to file Section 851 applications for the sale of its Blossom Hill Station Property #214 and First Street Station Property #276.[76] DRA also recommended that SJWC should be required to file a Section 851 application for the sale of its Doyle Street Property #181.

9.1.1. Properties #214 and #276

DRA determined from data responses received from SJWC that two properties were sold to SJWC's affiliate San Jose Land Company, without Commission authority, prior to SJWC determining that the properties were no longer necessary and useful. Hence, DRA recommended that SJWC be required to file a Section 851 application for Property #214 and Property #276. The following tabulation compares the dates provided to DRA from SJWC that these properties were transferred out of utility plant in service, memorandums designating non-utility status were prepared, and the properties were sold.[77]

Property	Transferred to Non-Utility Account	Justification Memorandum	Sold
#214	July 1997	March 6, 2001	December 1999
#276	April 2000	April 13, 2004	September 2000

As shown by the above tabulation, Property #214 was sold in December 1999, approximately three years prior to a March 2001 memorandum designating that property no longer useful for utility purpose. Similarly,

[76] Section 851 requires a utility to file an application for approval of a sale of utility property necessary or useful in the performance of its public utility responsibilities.

[77] Exhibit 9 at 11-6 and 11-8.

Property #276 was sold in September 2000, approximately four years prior to the April 2004 memorandum designating that property no longer useful for utility purpose.

SJWC's procedure in considering the removal of property from utility service has been to prepare a memorandum to evaluate the need for the property in regulated water service. However, the memorandum date does not determine when a property is no longer necessary and useful. The controlling issue is whether the property was actually necessary or useful at the time of the sale.

SJWC undertook a forensic investigation into its Microsoft WORD software to determine why the justification memorandums for these properties were dated after they were sold. It discovered that each time memorandums related to Properties #214 and #276 were opened, Microsoft WORD automatically updated the date listed on each memorandum to the date the document was opened for printing. Those changes in dates resulted from an employee who mistakenly activated a feature in the WORD program to automatically update a date when the memorandums were reopened over time.[78] The following tabulation shows the dates that the justification memorandums were initially issued, based on SJWC's forensic investigation.

[78] Exhibit 5 at 6-2 and 6-3.

Property	Transferred to Non-Utility	Initial Memorandum	Sold
#214	July 1997	May 13, 1999	December 1999
#276	April 2000	April 10, 2000	September 2000

The corrected memorandum dates substantiate that these properties were not sold prior to a determination that the properties were no longer necessary or useful for utility purposes. SJWC has also reasonably explained that an employee computer error caused the dates of its justification memorandums to be updated each time when those memorandums were printed.

Section 851 applications are not required for property that was not necessary or useful when sold.[79] SJWC should not be required to file Section 851 applications for Properties #214 and #276 because they were not necessary or useful when sold.

9.1.2. Property #181

DRA also recommended that SJWC should be required to file a Section 851 application for its sale of its Property #181 because SJWC did not provide advance notice of its proposed sale of that property as required by D.06-05-041.

D.06-05-041 specifically required water utilities, including SJWC, to provide the Director of the Division of Water and Audits and the Director of DRA 30 days' advance written notice whenever they plan to sell land, buildings, water rights, or all or part of a water system. This notice requirement applies to water utility assets that the water utility has determined are no longer used and

[79] Exhibit 9 at 11-7.

useful for utility purposes. Notice does not preclude later review of such sales in a water utility's GRC or a later proceeding.[80]

SJWC reported in its GRC minimum data response to DRA that Property #181 was no longer necessary or useful for public utility service and that it was in the process of selling that property but, due to inadvertence, SJWC had not provided the notice required by D.06-05-041.[81]

A memorandum justifying the transfer of Property #181 to non-utility use from plant in service was issued in November 2001, and the property was transferred to non-utility property on its accounting records on March 13, 2002, and sold in October 2008.[82] Although SJWC did not provide a formal written notice to the Directors, it did provide notice and disclose certain details of the sale in this GRC. Although SJWC disclosed to DRA its intent to sell the property not used or useful for utility purposes in advance of being sold, DRA did not review the transaction in this GRC. To require SJWC to file a Section 851 application for the review of a single transaction that involved the sale of property not used or useful for utility purposes that could have been reviewed in this GRC proceeding may not be a productive use of Commission or SJWC resources. However, there is insufficient information in this proceeding to substantiate without a doubt that Property #181 was no longer useful for utility purposes at the time of sale. SJWC should not be required to file a Section 851 application for the sale of its Property #181.

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[80] D.06-05-041 (2006), *mimeo*. at 77.

[81] Exhibit 5 at 6-3.

[82] Exhibit 9 at 11-9.

9.2. Non-Tariff Activities

SJWC operates a number of non-tariff activities that utilize utility assets and resources that would otherwise be underutilized. These non-tariff activities include billing services, operation and maintenance services, and antenna leases. Revenues received from these activities are allocated between SJWC's shareholders and ratepayers in accordance with the "Excess Capacity" rules and guidelines set forth in D.00-07-018 and as modified by D.04-12-023.[83] The ratepayers' share of these revenues is applied directly to revenue requirement as a composite credit (offset) to operating expenses, as addressed in the prior Non-Tariff Services section of this decision.

DRA did not undertake a full audit of SJWC's non-tariff activities in this GRC because it did not have the time or resources to do so. Concerned that the ratepayers' share of revenues from these non-tariff business activities may not be sufficient to cover all of the associated expenses, DRA recommended that the Commission order a full audit of SJWC's non-tariff activities in its next GRC.

SJWC is always subject to an audit in its GRCs, as acknowledged by DRA.[84] Therefore, it is not necessary to adopt DRA's audit recommendation.

10. Summary of Earnings & Rate Design

Our adopted Summary of Earnings is shown in Appendix A. It reflects the operating revenues that would be provided at present rates and those that will be required to produce the 8.80% currently authorized rate of return on rate base for the test year. That rate of return will produce additional revenues of

[83] Order Instituting Rulemaking 09-04-012 was opened on April 23, 2009 to develop standard rules for the use of regulated assets for non-tariff services.

[84] Reporter's Transcript Vol. 4, p. 480.

$18,597,000 in the test year, an increase of 9.24% over the revenues produced by existing rates. Appendix A also sets forth the resulting rates in the Tariff Schedules for the various classes of service.

Although the disposition of an under-collected balance in the Water Quality Expense Memorandum Account (WQMA) and over-collected balances in SJWC's balancing accounts were not addressed in the settlement agreements, no party opposed SJWC's proposal to recover its WQMA under-collected balance through a one-time $0.41 surcharge per service and disburse its balancing accounts' over-collected balances through a 12-month surcredit of $0.0278 per 100 cubic feet. We authorize these actions.

11. Pending Motion

SJWC filed an August 3, 2009 motion to strike portions of DRA's July 17, 2009 opening brief that referred to and/or relied on assertions about alleged facts not included in the evidentiary record. DRA filed an August 18, 2009 response in opposition to SJWC's motion. Only those facts found in the evidentiary record were considered in rendering this decision. Therefore, SJWC's motion is moot.

12. Comments on the Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311 and comments were allowed under Rule 14.3. Comments were filed on November 3, 2009, and reply comments were filed on November 9, 2009. The issues raised in these comments have been discussed in the text above as necessary.

13. Categorization and Need for Hearing

SJWC requested that this matter be categorized as ratesetting. By Resolution ALJ 176-3228, dated January 29, 2009, the Commission preliminarily

determined that this was a ratesetting proceeding and that hearings would be necessary. There was no objection to the ratesetting categorization.

A PHC was held on March 19, 2009 to establish issues and a hearing schedule. Following this PHC, on March 30, 2009, Commissioner Bohn issued a Scoping Memo and Ruling confirming that this was a ratesetting proceeding and set a schedule that included an evidentiary hearing.

14. Assignment of Proceeding

John A. Bohn is the assigned Commissioner and Michael J. Galvin is the assigned ALJ in this proceeding.

Findings of Fact

1. The burden of proof in GRC applications, such as this proceeding, rests upon SJWC to demonstrate the reasonableness of its request.

2. There were two settlement agreements in this proceeding, a partial results of operations agreement and an all-party rate design agreement.

3. Rate design is not in dispute.

4. The test year difference in purchased power expense between SJWC and DRA resulted from DRA imputing five-year average power costs previously incurred at the Columbine Station as an ongoing expense to be recovered from ratepayers.

5. The test year difference in recycled water expense between SJWC and DRA resulted from SJWC including and DRA excluding conservation expenses for retrofitting recycled water landscape irrigation services.

6. The test year difference in non-tariff services revenues between SJWC and DRA resulted from the use of different forecasting methods for revenues received from non-tariff activities.

7. The test year difference in Rent between SJWC and DRA resulted from DRA imputing rent for SJWC's headquarters building in lieu of allowing that building in rate base.

8. SJWC used the Commission Division of Water and Audits' Standard Practice U-4 methodology for calculating its composite depreciation rate.

9. DRA deviated from Standard Practice U-4 in determining a net salvage value for SJWC's T&D mains salvage value.

10. DRA's net salvage value proxy for SJWC's T&D mains was based on a three-year-old depreciation study of a different water company having a large service territory made up of several small water systems with newer T&D mains substantially smaller than SJWC's T&D mains.

11. The Commission Division of Water and Audits' Standard Practice U-4 applies a uniform methodology to calculate depreciation reserves and expenses.

12. Although the Columbine solar project was designed to produce 112,791 kWh of power, the actual 2008 performance was 10% below designed production.

13. SJWC proposed to construct and integrate into its operating system three hydro-turbine projects, one each year.

14. DRA does not oppose SJWC undertaking a Cox hydro-turbine project as a pilot project for a two-year period.

15. Neither the Alum Rock hydro-turbine project nor the Hostetter hydro-turbine project has wells or pumps at their locations.

16. The test year difference in Montevina Station project costs between SJWC and DRA resulted from a difference on need for this four-year project to meet new water quality standards.

17. Effective January 2008, stricter standards on individual filter effluent turbidity were imposed as part of IESWTR.

18. Effective April 2012, water sample points are expected to change to comply with an updated State DBP2.

19. Most of SJWC's surface water comes from the Montevina Station.

20. SJWC was cited by the California Department of Public Health in January and February of 2008 for exceeding IESWTR operating criteria at the Montevina Station.

21. The test year difference in recycled water mains expenses between SJWC and DRA resulted from a difference in how recycled water mains projects should be funded.

22. SJWC purchases recycled water through a SBWR Program, which currently delivers approximately 10,000 AFY of its 50,000 AFY capacity to San Jose and other South Bay cities.

23. SJWC proposed three recycled water projects, one for each year of its GRC cycle, to serve identified users of recycled water for irrigation purposes and, in the long-term, groundwater recharging.

24. SJWC must substantiate that it has matching funds to cover at least half of project costs to obtain recycled water mains funding from the U.S. Bureau of Reclamation or from the State Clean Water State Revolving Fund.

25. The test year difference in the Pipeline Replacement Program between SJWC and DRA resulted from SJWC seeking to increase its 0.5% baseline replacement rate of 13 miles per year by 4 miles per year with a goal of achieving a 1.0% replacement rate per year by 2011.

26. SJWC's water system, dating back to 1866, has piping up to 140 years old. SJWC has approximately 230 miles of cast iron pipe with an average age of 75 years, of which 50 miles are over 100 years old. It also has 1,150 miles of steel pipe at an average age of 50 years, of which 20 miles are over 80 years old.

27. The test year difference in the meter replacement program between SJWC and DRA resulted from a difference regarding whether SJWC had a surplus of 1″ and smaller meters in inventory.

28. General Order 103 sets forth rules prescribing minimum standards for water utilities to follow.

29. General Order 103 precludes SJWC from keeping meters smaller than 1″ in service for more than 20 years and 1″ meters in service for more than 15 years without being pulled, tested, or replaced.

30. The test year difference in the service replacement project between SJWC and DRA resulted from a difference in their assumptions regarding how much pipeline would be approved for replacement in this proceeding.

31. D.08-10-018 authorized SJWC to track costs of owning and renovating a new Main Office at the Taylor building and the Bascom building in a memorandum account for possible rate base recovery in this GRC.

32. SJWC found only eight buildings that met at least some of its minimum criteria for a replacement building in the downtown San Jose area, six of which were available for purchase and two for lease.

33. The lease alternative adopted by D.08-10-018 for a new Main Office was based on square footage needed to replicate and upgrade the old Main Office space.

34. D.08-10-018 found that a lease option for the Bascom building was the least cost alternative to purchasing the building.

35. SJWC's Engineer and Construction Department has occupied the entire second floor of the Bascom building under a lease agreement since 1999.

36. SJWC has requested authority to establish a fluoridation memorandum account.

37. California Health and Safety Code Section 116415 requires a water utility to implement fluoridation into its water system if third party funding is available to cover the capital costs and the first year's operations.

38. Health Trust has yet to commit fluoridation funding for capital improvements and first year's operations.

39. SJWC should not be required to file Section 851 applications for Properties #214 and #276 because they were not necessary or useful when sold.

40. SJWC reported in its GRC minimum data response to DRA that Property #181 was no longer necessary or useful for public utility service and that it was in the process of selling that property.

Conclusions of Law

1. The partial settlement agreement submitted by the parties is reasonable in light of the whole record, consistent with the law, and in the public interest.

2. The all-party rate design settlement agreement submitted by the parties is reasonable in light of the whole record, consistent with the law, and in the public interest.

3. The adoption of the partial and all-party settlement agreements does not constitute approval of, or create precedent regarding, any principle or issue in this proceeding or in any further proceeding.

4. DRA's imputed purchased power adjustment is not reasonable and should not be adopted.

5. Recycled water retrofit expenses proposed by SJWC are reasonable and should be adopted.

6. DRA's revenue forecast for non-tariff services is reasonable and should be adopted.

7. SJWC's rent expense forecast increased by $329,000 to reflect the cost of leasing the Bascom building is reasonable and should be adopted.

8. SJWC's 3.51% composite depreciation rate based on the Commission Division of Water and Audits' Standard Practice U-4 methodology is reasonable and should be adopted.

9. The Columbine solar project should continue as a pilot solar project in rate base so that SJWC can gather operational performance data to determine whether the pilot project matches expectations and benefits ratepayers.

10. The Cox hydro-turbine project is reasonable and should be adopted because it would directly benefit SJWC and its ratepayers by enabling SJWC to use its own produced energy to run its Cox facilities, and would assist SJWC in providing reliable water service to its ratepayers during peak purchased power demands, curtailments and revolving outages while reducing its purchased power needs.

11. Any power generated at the Alum Rock and Hostetter sites by hydro-turbine units must be sold back to PG&E under a power purchase agreement.

12. Hydro-turbine projects that directly benefit SJWC and its ratepayers in providing quality and reliable water service while reducing its purchased power consumption should be given priority over hydro-turbine projects that do not.

13. The Alum Rock and Hostetter hydro-turbine projects should not be approved at this time.

14. The $209,000 forecasted Montevina Station facilities plan study is reasonable and should be approved.

15. With the Montevina Station project being at an early stage of planning, the remaining project costs should not be approved until a facilities plan study has been completed and a specific project design has been established.

16. SJWC should file a separate application outside of this GRC seeking approval of its project costs and recovery for upgrading its Montevina Station to

maintain water quality and to increase its capacity to treat surface water upon completion of a facilities plan study and specific project design.

17. Recycled water has become a viable and reliable alternative to offset potable water demands for irrigation and industrial use as well as for stream flow augmentation, including groundwater recharge.

18. Completion of recycled water mains funding applications does not assure funding, let alone immediate receipt of any approved funds.

19. The recycled water projects are reasonable and should be approved. However, SJWC should not be relieved of seeking partners to share in its reclaimed water projects or of seeking public grants and funding.

20. Any partnership, public grant, and funding that SJWC receives for its water recycled projects should be credited to ratepayers as Contribution in Aid of Construction upon receipt.

21. As part of its next GRC application, SJWC should substantiate the process and results of the process it undertook to obtain partners to share in the costs and to obtain and receive public grant and tax exempt funding for its reclaimed water projects.

22. It is reasonable and appropriate to adopt SJWC's Pipeline Replacement Program for this GRC cycle.

23. DRA's forecast for SJWC's meter replacement program is reasonable and should be adopted.

24. SJWC should provide a written report to the Director of the Division of Water and Audits explaining its 2007 and 2008 small meter backlog and whether that backlog resulted in a General Order 103 violation.

25. SJWC should also address in its written meter report whether our adoption of DRA's meter replacement forecast will preclude SJWC from complying with General Order 103-A.

26. The forecasted service replacement program of SJWC is consistent with the pipeline replacement program being adopted in this proceeding and should be adopted.

27. If SJWC believes that it may have been in violation of General Order 103 because of its backlog meter replacement program or that it may be in violation of General Order 103-A because insufficient funds were approved for its meter replacement program during this GRC cycle, SJWC should file an application to bring it into compliance with General Order 103-A.

28. Floor space should not be the sole criterion for determining whether SJWC should lease instead of purchasing a building. Factors such as building location, safety, security, access for disabled persons, and ability to upgrade the building's systems and infrastructures are necessary attributes to ensure adequate facilities.

29. SJWC's purchase of the Taylor building and all of its related remodeling costs were reasonable and should be included in rate base.

30. The Bascom building purchase price should be excluded from rate base.

31. The California Health and Safety Code requires this Commission to approve rate increases for a public utility water system within 45 days of the filing of an application or advice letter in accordance with our requirements showing in reasonable detail the amount of additional revenue required to recover fluoridation associated costs.

32. If sufficient funds are guaranteed to SJWC for the capital improvements necessary for fluoridation plus the costs of the first year's operation, SJWC should be authorized to file a Tier 2 advice letter to establish rates to recover the incremental O&M costs incurred in operating the fluoridation system beyond the first year. This advice letter should be filed no earlier than 90 days before the end of the first year of operation. The rates requested should be based on the actual recorded costs of operation, and subject to refund if those costs are found

to be unreasonable. The advice letter should explain why the costs whose recovery is requested are incremental, and not already included in rates.

33. SJWC has reasonably explained that an employee computer error caused the dates of its justification memorandums for Properties #214 and #276 to be updated each time when those memorandums were printed. Section 851 applications should not be required for these properties.

34. SJWC should file a Section 851 application for the review of a single transaction that involved the sale of Property #181.

35. The Summary of Earnings and resulting rates in Appendix A are reasonable and should be adopted.

36. This decision should be effective the date signed

O R D E R

IT IS ORDERED that:

1. The San Jose Water Company and Division of Ratepayer Advocates' partial settlement agreement attached to this decision as Appendix B, that reduced their test year 2010 operating revenue differences to $15,385,000 from $23,685,000 and rate base differences to $46,026,000 from $59,451,000, is adopted. The settled issues include: (1) average annual water sales of 960 hundred cubic feet per business customer; (2) annual purchased water of 3,094 million gallons; (3) establishment of a pension balancing account as detailed in Ordering Paragraph 6; (4) advice letter treatment for the Greenridge Terrace Tank #2 replacements; (5) two new wells at Needles Station; and, (6) retaining a $500,000 cap on the Water Quality Memorandum Account.

2. The San Jose Water Company, Division of Ratepayer Advocates, Mutual Water Companies, and Redwood Estates Services Association's all-party rate

design settlement agreement that provided for Mountain District customers to pay the same service charges in effect for all of the utility's remaining customers and the establishment of an Interruptible Service Clause Tariff attached to this decision as Appendix C is adopted.

3. The rate tables and tariff sheets in Appendix A are adopted.

4. San Jose Water Company is authorized to file in accordance with General Order 96-B tariffs containing the 2010 test year increase as provided in Appendix A. The revised rates shall apply to service rendered on and after January 1, 2010 or the tariff's filing effective date, whichever occurs later.

5. On or before November 5, 2010 and November 5, 2011 respectively, San Jose Water Company is authorized to file in accordance with General Order 96-B, a Tier 1 advice letter, with appropriate supporting workpapers, requesting an escalation adjustment for 2011 and 2012, to be calculated in conformance with the Rate Case Plan adopted in Decision 07-05-062 and Appendix A. The advice letters shall be reviewed by the Commission Division of Water and Audits for conformity with this decision, including the applicable provisions of the settlements, and shall go into effect not less than five days notice, not earlier than January 1, 2010 and January 1, 2011, respectively. The tariffs shall be applicable to service rendered on or after the effective date.

6. San Jose Water Company is authorized to establish a pension balancing account, effective January 1, 2010, to record cash contributions to the retirement plan, with San Jose Water Company's recovery of this expense for ratemaking purposes capped at the level of pension expense calculated according to the method prescribed by Statement of Financial Accounting Standards #87 for each concurrent year.

7. San Jose Water Company is authorized to file a Tier 2 advice letter for recovery of costs incurred in its Greenridge Terrace Tank #2 replacement project with a budgetary cap of $2,200,000.

8. San Jose Water Company shall file a separate application outside of its general rate case proceeding seeking approval of project costs and recovery for upgrading its Montevina Station to maintain water quality and to increase its capacity to treat surface water, upon completion of a facilities plan study and specific project design.

9. San Jose Water Company shall substantiate as part of its next general rate case application the process and results of the process it undertook to obtain partners to share in the costs and to obtain and receive public grant and tax exempt funding for its reclaimed water projects.

10. San Jose Water Company shall provide a written report to the Director of the Division of Water and Audits within 90 days after the effective date of this decision that explains its 2007 and 2008 small meter backlog and whether that backlog may have resulted in a General Order 103 violation during that period.

11. If San Jose Water Company believes that it may have violated General Order 103 during 2007 or 2008 or that it may violate General Order 103-A during any year of this general rate case cycle (2009-2012) regarding its meter replacements, San Jose Water Company shall file a new application separate from this proceeding explaining the circumstances of its possible violation or violations and proposing a solution to bring it into conformance with General Order 103-A within 150 days after the effective date of this decision.

12. If sufficient funds are guaranteed to SJWC for the capital improvements necessary for fluoridation plus the costs of the first year's operation, SJWC is authorized to file a Tier 2 advice letter to establish rates to recover the incremental O&M costs incurred in operating the fluoridation system beyond the

first year. This advice letter shall be filed no earlier than 90 days before the end of the first year of operation. The rates requested shall be based on the actual recorded costs of operation, and subject to refund if those costs are found to be unreasonable. The advice letter shall explain why the costs whose recovery is requested are incremental, and not already included in rates.

13. San Jose Water Company is authorized to recover the under-collected balance in its Water Quality Expense Memorandum Account through a one-time surcharge of $0.41 per service.

14. San Jose Water Company is authorized to disburse its over-collected balances in its water rate assistance program, purchased power, purchased water, and pump tax balancing accounts through a 12-month surcredit of $0.0278 per 100 cubic feet.

15. San Jose Water Company shall file a Section 851 application for the sale of its Property #181.

16. Application 09-01-009 is closed.

This order is effective today.

Dated November 20, 2009, at San Francisco, California.

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