BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

In the Matter of Application of SAN JOSE WATER COMPANY (U168W) for Authority to Adjust Its Cost of Capital and to Reflect That Cost of Capital in Its Rates for the Period from January 1, 2018 through December 31, 2020.	A.17-04-001 (Filed: April 3, 2017)
Application of Golden State Water Company (U133W) for Authority to Establish its Authorized Cost of Capital and Rate of Return for Utility Operations for 2018-2020.	A.17-04-002 (Filed: April 3, 2017)
Application of California-American Water Company (U210W) for Authority to Establish its Authorized Cost of Capital for the Period from January 1, 2018 through December 31, 2020.	A.17-04-003 (Filed: April 3, 2017)
Application of CALIFORNIA WATER SERVICE COMPANY (U-60-W) for Authority to Establish its Authorized Cost of Capital for the Period from January 1, 2018 through December 31, 2020.	A.17-04-006 (Filed: April 3, 2017)

COMMENTS OF SAN JOSE WATER COMPANY (U-168-W) ON PROPOSED DECISION OF ADMINISTRATIVE LAW JUDGE BEMESDERFER

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COMMENTS
OF SAN JOSE WATER COMPANY (U-168-W)
ON PROPOSED DECISION OF
ADMINISTRATIVE LAW JUDGE BEMESDERFER

In accordance with Rules 14.3(a) and (b) of the Commission's Rules of Practice and Procedure, Applicant San Jose Water Company ("SJWC") hereby respectfully submits its Comments on the Proposed Decision of Administrative Law Judge ("ALJ") Karl Bemesderfer, which was mailed on February 6, 2018, in this consolidated proceeding. As specified in Rule 14.3(c), SJWC's Comments focus on factual and legal errors in the Proposed Decision ("PD"), several of which are very serious and merit the close attention of every Commissioner.

I. THE PROPOSED DECISION RELIES ALMOST EXCLUSIVELY ON ORA'S TESTIMONY WHILE IGNORING THAT OF THE APPLICANTS.

The Proposed Decision of ALJ Bemesderfer fails to provide an objective, balanced review of the evidentiary record. To the contrary, the Proposed Decision reflects reliance almost

exclusively on the testimony of ORA's witnesses, to the point that substantial segments of the Proposed Decision read like a paraphrase of ORA's briefs. In fact, as will be discussed later in these comments, ALJ Bemesderfer's treatment of ORA's claim that SJWC and other Applicants "double-counted" the cost of bond redemption premiums consists mainly of his incorporation into the Proposed Decision, almost *verbatim*, of the relevant passages of ORA's opening brief. The rebuttal testimony of the Applicants' experts, responding critically to ORA's testimony and demonstrating substantial errors in that testimony on issues ranging from the application of equity cost models to the calculation of debt costs and capital structure, is completely ignored.

In the few instances where the Proposed Decision addresses issues of controversy in the testimony of the Applicants' and ORA's witnesses, the Proposed Decision opts in every case for ORA's position, but without any weighing of the evidence. The only references by name to any of the Applicants' witnesses are to a trio of statements by California Water Service Company ("CWS") witness Vilbert allegedly acknowledging ORA's equity cost expert witness's use of a particular equity cost model.[1] Dr. Vilbert's thorough critique of the ORA analysis as well as the testimony of SJWC witness Ahern and the other Applicants' equity cost witnesses – both in support of their equity cost analyses and in critique of ORA's – go entirely unmentioned and ignored in the Proposed Decision.

In previous cost of capital proceedings, ALJ Bemesderfer has provided a thorough analysis of parties' conflicting recommendations for determining the costs of capital for a single water utility[2] or in evaluating the merits of an all-party settlement in a multi-utility proceeding.[3] In the present complex proceeding, consolidating applications by four Class A water utilities that were contested on all issues, the ALJ apparently looked for a simplified path to decision by focusing his attention on the analysis of ORA's witnesses and the summaries of the record provided in ORA's briefs. This unbalanced approach deprives the Commission of a fair and

[1] PD, at 19-20.
[2] *See, e.g., Valencia Water Co.*, D.07-06-024.
[3] *See*, *California Water Service Co.,* D.12-07-009. The ROEs for SJWC and two others of these utilities have since been reduced to 9.43% by operation of the Water Cost of Capital Mechanism ("WCCM").

thorough summary of the evidentiary record and would deny a fair hearing to SJWC and the other Applicant water utilities.

II. THE PROPOSED DECISION'S ADOPTED RETURNS ON EQUITY ARE DRASTICALLY OUT OF LINE WITH RETURNS RECENTLY GRANTED TO OTHER UTILITIES AND IN OTHER JURISDICTIONS.

The Commission's most recent determination of a fair return on equity ("ROE") for the four Applicant water utilities was in July 2012, when the Commission approved a settlement providing for a 9.99% ROE.[4] Five months later, in a fully contested proceeding, the Commission adopted ROEs for the four major energy utilities ranging from 10.10% to 10.45%[5] -- all less than 50 basis points higher than the Commission had recently authorized for the four Applicant water utilities. In May 2013 – after another five month interval – the Commission approved a settlement providing a 9.79% ROE for five smaller Class A water utilities.[6] Thereafter, in consideration of the relative stability of financial markets, the Commission allowed deferral of cost of capital reviews for both water and energy utilities. In December 2016, the Commission granted an ROE of 10.80% to several small local exchange telecommunications utilities.[7]

Most recently, in July 2017, the Commission, noting that "financial markets have remained relatively stable over recent years," granted a petition to allow a further two-year extension of cost of capital filing requirements for the four major energy utilities while modestly reducing their authorized ROEs (by five to 15 basis points) to a range from 10.05% to 10.30%.[8] This latest decision noted concern about a Memorandum of Understanding ("MOU") among the petitioning parties[9] by which the energy utilities committed to fund and implement "an unrelated program" intended to help low-income ratepayers qualify for housing subsidies – implying that this

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[4] *Id.* at 2, 21.
[5] *See, Southern California Edison Co.*, D.12-12-034, at 3, 52-53.
[6] *See, Park Water Co., D.13-05-027*, at 2, 21.
[7] *See, Calaveras Tel. Co.*, D.16-12-035, at 2.
[8] *See, Southern California Edison Co.*, D.17-07-005, 7-8, 10-11.
[9] The four energy utilities along with two consumer interest groups (ORA and TURN) had jointly petitioned for the extension of time accompanied by the modest ROE reductions.

act of "charity" may have swayed ORA and TURN to support the proposed ROEs.[10] Meanwhile, the record shows that the national average of ROEs granted to water utilities were 9.68% in 2016 and 9.43% for the first five months of 2017.[11]

SJWC recounted this history of recent ROE determinations in its opening brief, specifically noting the Commission's July 2017 approval of the joint petition of the four major energy utilities, ORA, and TURN to set ROEs in a range from 10.05% to 10.30% while deferring the next cost of capital applications for the energy utilities for two years. SJWC also noted that this approval was based in part on a Commission finding that "[t]he requested reductions in authorized ROE reflect financial market stability since 2012."[12]

Despite this ample evidence of "comparable" ROEs, the Proposed Decision would cut the allowed ROEs for the four Applicant water utilities to a range of just 8.22% to 8.30%. The Proposed Decision finds a way to ignore this history of recently allowed ROEs by an exercise in tricky logic. After recognizing the national average of recently granted ROEs for water utilities in a range of 9.43% to 9.68% and the Commission's recent allowances of 10.05% to 10.30% for energy utilities, the Proposed Decision notes that the Applicants requested ROEs substantially higher than those ranges but provided no evidence to substantiate that their businesses are riskier than either the national water utilities or the major California energy utilities – and so concludes that "we have no reason to consider either the national water utilities' average ROEs or the California energy utilities' ROEs as benchmark in this proceeding." The Proposed Decision then turns to the parties' financial model results, picking and choosing among them to justify adoption of ROEs for each Applicant precisely at the level proposed by ORA.

The trouble with the Proposed Decision's logic is that while the recently authorized ROEs for water utilities nationally and for energy and telecommunications utilities in California may not sufficiently support the significantly ***higher*** ROE recommendations of the Applicants'

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[10] *Id.* at 4-5.
[11] *See*, Exhibit GSW-7, at 2-3; *see also*, PD at 24 (Findings of Fact 4 and 5).
[12] SJWC Opening Brief, at 4-5, 34-35, *citing* D.17-07-005, *supra*, at 14 (Finding of Fact 4).

experts to justify adoption of those recommendations, neither do those recently authorized ROEs support the significantly ***lower*** ROE recommendations of ORA. Neither is the Proposed Decision's adoption of ORA's recommended ROEs justified by any major change in financial markets. Indeed, as recently as July 2017, as just noted, the Commission recognized a five-year period of "financial market stability."

The recent and current determinations of ROE by this Commission and other regulatory agencies discussed above establish three important and undeniable facts:

1. Over the past five years there has been a gradual, but slight, reduction in authorized ROEs.

2. The Commission has consistently granted slightly higher ROEs to energy and telecommunications utilities than to Class A water utilities.

3. Despite these slight variations, the range of ROEs granted nationally to water utilities and in California to all classes of utilities has been a narrow one – varying from 9.43% to 10.80%.

Based on these facts, the Commission should grant ROEs to SJWC and the other Applicants no lower than the bottom of that recently applied range – 9.43%.

III. THE PROPOSED DECISION SEEKS TO JUSTIFY ITS UNUSUALLY LOW ROE ALLOWANCES BASED ON AN UNJUSTIFIED ASSERTION THAT THEIR EQUITY IS "NEARLY RISK-FREE."

The Proposed Decision claims that the Commission's regulatory scheme provides a variety of protections to the Applicants that make them "nearly risk-free," thus justifying downward adjustments in allowed ROE.[13] This claim is simply wrong.

The Proposed Decision purports to rely in this regard on an ORA argument that:

> [T]he risk-hedging and risk-spreading mechanisms adopted by this Commission over the years have effectively guaranteed that the Applicants will earn their allowed returns on rate base, making investment in their common equity nearly risk free and their ROEs should be adjusted downward to reflect this fact.[14]

The Proposed Decision then lists a series of "such mechanisms," including the Water Rate Adjustment Mechanism ("WRAM"), the Water Capital Cost Mechanism ("WCCM"), "various

[13] PD, at 5.
[14] *Id.*

'balancing accounts'," an escalation adjustment mechanism for years between general rate cases, and "various specific advice letters relating to particular rates and charges which, if not the subject of timely protests, typically become effective 30 days after filing."[15]

ORA did, indeed, present an argument along the lines the Proposed Decision describes, although even ORA did not dare to assert that the Commission's regulatory mechanisms make the Applicants "nearly risk-free." What ORA contended was that "[t]he risk of failing to recover operating expenses is low" and "[b]alancing accounts and rate adjustment mechanisms shift risks away from utilities to consumers, insulating utilities from market volatility and financial risk."[16]

ORA supports its claim of risk-shifting by a series of references to prior Commission decisions. Each of these decisions, where cited by ORA, asserts that the Commission's regulatory framework for water utilities is "strong" and "robust" and responds to the utilities' needs by allowing balancing and memorandum accounts and a regular cycle for GRCs. These past decisions emphasized the risk-limiting value of such procedures not to assert that they made water utilities "nearly risk-free" but for the much more limited purposes of asserting that regulated utilities have "an opportunity to earn a fair return," and denying certain utilities' claims that they were entitled to company-specific risk premiums due to an especially "risky" regulatory environment.[17]

In its reply brief, SJWC noted that ORA was incorrect in claiming that balancing accounts and rate adjustment mechanisms shift risks from utilities to consumers – when in fact they are ***two-way*** mechanisms, benefiting either the utility or its customers depending on how reality varies from past forecasts. As SJWC explained,

> A balancing account allows recovery of the actual cost, adjusting rates up or down to achieve that result. From a risk perspective, the risk of a substantial

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[15] *Id.*
[16] ORA Opening Brief, at 6.
[17] *See, California Water Service Company*, D.09-05-019, at 6-7, 27-29, 31-32; *Great Oaks Water Company*, D.10-12-057, at 7-8.

> deviation from the authorized rate of return is reduced, but the reduction works both ways, providing equivalent protection to both the utility and its customers.[18]

SJWC also noted that ORA misunderstood the relevance of various revenue or rate adjustment mechanisms to SJWC's regulatory risk profile and provided no support for its claim that the three-year rate case cycle reduces utility risk.[19] ORA had no authority for its claim that "rate adjustment mechanisms shift risks away from utilities to consumers," and compounded the error by falsely asserting that SJWC was seeking an increased return on equity due to "increased risk posed by WRAM and MCBA."[20] The fact is that ORA has fought to deny – and been successful in denying – a WRAM for SJWC in SJWC's two most recent GRCs. Therefore, SJWC faces a ***higher risk*** even by ORA's acknowledgement.

The Proposed Decision's doubling down on ORA's claim that "[b]alancing accounts and rate adjustment mechanisms shift risks away from utilities to consumers, insulating utilities from market volatility and financial risk," ignores the question whether the Applicants have ***in fact*** earned their allowed returns, whether the mechanisms to which ORA referred do ***in fact*** hedge and spread risk solely to the Applicants' benefit, and whether other utilities in the Water Proxy Group operate in riskier regulatory environments. The Proposed Decision fails to cite to evidence in the record supporting any of those contentions. That is not surprising, since the record is devoid of such evidence.

The Proposed Decision's claim that the Commission's regulatory scheme results in the Applicants being "nearly risk-free" and so justifies drastic ROE reductions also is plainly ***inconsistent*** with the Proposed Decision's rejection of all the Applicants' proposals for recognition of company-specific risk factors on the basis that the alleged risks are not "non-

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[18] SJWC Reply Brief, at 2-3. The only one-way mechanisms of which SJWC is aware are conservation expense balancing accounts, which ORA has insisted operate only to refund "underspending" of the amount allowed in a GRC, with no opportunity to recover costs in excess of the GRC allowance. *See, e.g., San Jose Water Co.*, D.16-06-004, at 16-19, 43 (Finding of Fact 15), 45 (Conclusion of Law 6), 48 (Ordering Paragraph 11).

[19] SJWC Reply Brief, at 3-6.

[20] ORA Opening Brief, at 6-7, 8-9.

diversifiable" and so cannot effect ROE.[21] If unfavorable company-specific risk factors have no effect on the cost of equity, then the same must be true of company-specific risk factors that work in their favor. SJWC pointed out this inconsistency in its reply brief, finding it "curious that ORA devotes so many pages, inaccurate as they are, to alleging risk reductions due to a variety of regulatory mechanisms, given that ORA's expert, Mr. Rothschild, contends that only non-diversifiable risks may be taken into account in determining the cost of equity capital."[22] This contradiction and the Proposed Decision's failure to address it demonstrate the ***result-oriented bias*** of the Proposed Decision.

In the context of such a lopsided and unfair Proposed Decision, it is imperative that the Commissioners take the time to understand key elements of the outcomes they are being asked to impose on the four Class A water utilities whose costs of capital are being determined for the next three-year period. Among these are the reductions of more than 100 basis points that the Proposed Decision would make in the Applicants' currently authorized costs of equity, setting ROEs nearly 200 basis points lower than the Commission authorized for major energy utilities just seven months ago and at least 250 basis points lower than the Commission authorized for a group of small telephone companies in December 2016.

IV. THE PROPOSED DECISION MAKES SERIOUS ERRORS BY ITS WHOLESALE ADOPTION OF ORA'S FLAWED ANALYSIS AND CALCULATION OF DEBT COSTS.

The Proposed Decision refers to the testimony of SJWC's Chief Financial Officer, James Lynch, along with that of the other Applicants' witnesses on debt cost issues, in a single paragraph summarizing the Applicants' methods for calculating annual cost of debt, but rejects their estimates "where differences exist" based on ORA's claim of "double-counted issuance

[21] PD, at 19-20.

[22] SJWC Reply Brief, at 4 n. 8, *citing* Exhibit ORA-20 (Rothschild), at 46-48. SJWC noted that the ORA witness considered "weather" to be a diversifiable risk (Tr. 278:28-279:1), making it difficult to see how he could justify paying attention to regulatory mechanisms like WRAM/MCBAs and water cost balancing accounts that reduce exposure to the effects of weather on water sales or water supply costs. SJWC Reply Brief, at 4 n. 8. ***The PD ignored this point, along with the rest of SJWC's reply brief.***

costs."[23] While these references to the Applicants' testimony on the cost of debt might imply that ALJ Bemesderfer considered their arguments, a comparison of this portion of the Proposed Decision with ORA's opening brief indicates otherwise. In fact, the Proposed Decision's references to the Applicants' testimony simply came along for the ride with ALJ Bemesderfer's wholesale incorporation of the "Cost of Debt" section of ORA's brief.

The Proposed Decision lifts its entire discussion of the cost of debt from ORA's opening brief, with only minor changes of wording and word order. At the very outset of that discussion, under the "Cost of Debt" heading of Section 7 on page 20, the Proposed Decision revises the opening sentence on this topic at page 36 of ORA's opening brief by replacing ORA's request, "The Commission should adopt ORA's proposed cost of debt," with the declaration that, "We adopt ORA's proposed costs of debt." The wording of the Proposed Decision that follows, through the penultimate sentence of Section 7 on page 23, is virtually identical to the wording of ORA's opening brief, from the end of page 36 through the first line on page 39 of that brief.[24]

Unfortunately, the ORA analysis and argument relating to the Applicants' cost of debt was deeply flawed and its wholesale incorporation into the Proposed Decision makes the Proposed Decision deeply flawed in its treatment of the subject as well. The major issue recognized by the Proposed Decision is ORA's claim of "double-counting" of early redemption premium costs by SJWC, GSW, and California American Water Company. With respect to SJWC, ORA's witness also made serious errors in his statement of interest expense associated with a planned debt issuance and in his averaging of annual debt balances. ***The Proposed Decision adopts all these mistakes***, without even mentioning the latter two of them.

SJWC explained in its opening brief the error ORA witness Dawadi made by removing what he claimed were "double-counted issuance costs of approximately 3.49 million" from

[23] PD, at 21. The PD also criticizes Golden State Water Company ("GSW") for "unsubstantiated redemption premiums." *Id.*

[24] *Compare*, PD, Section 7, at 20-23, with, ORA Opening Brief, at 36-39. The concluding sentence in the first paragraph on ORA's page 39 was unintelligible, which may be why the Proposed Decision substituted the following summary conclusion to Section 7: "We reject the inclusion of this second type of cost in current cost of debt."

SJWC's cost of debt. SJWC noted that Mr. Dawadi failed to include in his calculation of SJWC's debt cost the early redemption premium on several series of SJWC bonds that were refinanced in 1993 with the Commission's approval.[25] SJWC restates much of this explanation, because it applies to the Proposed Decision just as it did to ORA's analysis. As SJWC stated:

> Mr. Lynch explained that amounts paid to redeem bonds with a new debt instrument reduce the net proceeds from the new issue.[26] . . . He testified that SJWC properly included the amount it paid to redeem the First Mortgage Bonds, amounting to $3,485,275, as a reduction of loan proceeds from debt borrowings in its weighted average effective interest rate calculation. He reflected this cost as a separate line item in Schedule 6.1 and did not include it in Series B Senior note issuance costs, so there was no double counting as alleged by Mr. Dawadi.[27]
>
> Mr. Dawadi, incorrectly identifying the bond redemption premium as a double counting error, failed to reflect it as a reduction of net proceeds. Since both the bond redemption premium and debt issuance costs reduce borrowing proceeds, they should be treated consistently, as a reduction of net proceeds, in determining the weighted average effective interest rate. The net proceeds, reduced by both these costs, represents the proceeds actually received by SJWC, so it is the proper denominator to use in the weighted average effective interest rate calculation, just as interest expense plus amortization of both bond issuance costs and bond redemption premium comprises the proper numerator.[28] This is not double counting, but rather a proper recognition of both the correct amount of bond proceeds and the correct cost of servicing that debt.[29]

ORA's opening brief responded to Mr. Lynch's testimony on this issue by challenging his call for treating redemption premiums and debt issuance costs consistently as a reduction of Net Proceeds. According to ORA,

> There is a fundamental difference between the two types of unamortized debt costs presented in Applicants' proposals that should not be conflated." One type of unamortized debt cost is attached to existing debt, which may have been issued in order to retire higher-cost debt early, thereby generating

[25] SJWC Opening Brief, at 45-46.
[26] Exhibit SJ-02 (Lynch), at 9, *quoting*, FASB Accounting Standards Codification 980-470-40-2.
[27] Exhibit SJ-02 (Lynch), at 9; Exhibit SJ-01, Schedule 6.1; Exhibit SJ-03 (Lynch), Schedule JPL-1R, Scheduled 6.1 (Corrected by JPL).
[28] Exhibit SJ-02 (Lynch), at 10.
[29] SJWC Opening Brief, at 46-47. SJWC concluded this discussion by noting that the Commission's two most recent decisions addressing SJWC's cost of capital, D.10-10-035 and D.12-07-009, allowed the bond redemption premium as a reduction of net proceeds in determining the effective interest rate, and that not allowing such recognition would conflict with accounting rules but also would create a perverse incentive for utilities not to refinance high interest rate debt, to the detriment of ratepayers. SJWC Opening Brief, at 47.

> unamortized costs and possible early redemption premiums that have not been amortized in rates. The second type of costs that the Applicants propose to recover are not associated with any particular existing issuance but rather have been attached to an existing issuance out of convenience.[30]

SJWC's reply brief responded directly to this ORA argument. Here is what SJWC had to say in response to ORA's claim that SJWC's bond redemption premium of $3,485,275 was a "type of costs . . . not associated with any particular existing issuance but rather . . . attached to an existing issuance out of convenience":

> Because the redemption premium was created when the Bonds were refinanced, it was ***never*** a part of the issuance costs of the retired First Mortgage Bonds. All issuance costs of the retired First Mortgage Bonds were ***written off*** at the time they were redeemed.
>
> As explained in Mr. Lynch's rebuttal testimony, since the redemption premium was created to redeem the First Mortgage Bonds, it attaches to the new debt as a component of the new debt issuance costs . . . to be capitalized as an asset and amortized over the life of the new debt . . . . This "attachment" is not a matter of convenience; rather, it is ***required*** by the applicable financial accounting standard. As Mr. Lynch testified, Financial Accounting Standards Board Accounting Standards Codification 980-470-40-2 prescribes that "a regulated entity shall capitalize the excess (of the cost of reacquired debt (the Series B Senior Notes) over the net carrying amount of the old debt) as an asset and amortize it over the period during which it will be allowed for rate-making purposes. This is also the adopted regulatory treatment." Following this guidance, the First Mortgage Bonds redemption premium was not expensed at the time it was paid, but instead was capitalized as an asset part of the new Senior B Series Notes issuance costs, which are now being amortized ratably to expense over the life of the Series B Senior Notes.
>
> Thus, contrary to ORA's recommendation, SJWC's debt cost calculations include no "double counted unamortized issuance costs and redemption premium costs associated with the loans that have already been paid."
>
> Unamortized issuance costs associated with the Bonds refinanced in 1993 were written off at that time. The redemption premium created at that time became part of the deferred issuance costs of the still outstanding Series B Senior Notes. Those issuance costs are being amortized ratably over the 30-year life of the Series B Senior Notes. There is no double counting as alleged by ORA.[31]

SJWC now quotes the above passage from its reply brief, summarizing the rebuttal testimony of SJWC's witness and CFO, Mr. Lynch, because ***the Proposed Decision*** – parroting,

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[30] ORA Opening Brief, at 38-39.

[31] SJWC Reply Brief, at 23-24 (footnotes referencing Mr. Lynch's rebuttal testimony deleted).

as it does, the words of ORA's opening brief – ***obviously fails to consider that evidence***. As SJWC concluded, there was "no double counting as alleged by ORA" and the Proposed Decision is wrong in adopting ORA's flawed analysis as its own.

The unfounded "double counting" claim was not ORA's only error in the calculation of the cost of debt for SJWC. Mr. Dawadi also incorrectly understated the annual interest expense for 2019 associated with SJWC's planned issuance of $80 million of new debt in that year. He also applied a faulty averaging method in trying to calculate the weighted average cost of debt for the three-year period 2018-2020, applying a simple average method that ignored the impact of the beginning balances for each year for the three-year average. Mr. Lynch adjusted Mr. Dawadi's calculations to correct these mistakes along with reflecting the redemption premium cost discussed above, resulting in an average cost of debt of 6.20% -- the same cost calculated by Mr. Lynch and proposed by SJWC.[32]

SJWC summarized all these points in its opening brief and further explained Mr. Dawadi's averaging error in its reply brief.[33] The Proposed Decision simply ***ignores*** these additional errors by Mr. Dawadi, reaching an unsubstantiated and erroneous finding that "[a]fter elimination of double-counted costs, ORA's calculated costs of debt are not materially different from those proposed by Applicants."[34]

V. IN ADOPTING ORA'S ESTIMATES OF THE APPLICANTS' CAPITAL STRUCTURES, THE PROPOSED DECISION DEVIATES FROM THE COMMISSION POLICY OF FUTURE TEST YEAR RATEMAKING WITHOUT EVEN RECOGNIZING THAT IT IS DOING SO.

In the determination of capital structure for SJWC, the Proposed Decision is equally flawed, but for different reasons. The Proposed Decision devotes just one paragraph to determining the capital structures of all four Applicant utilities, addressing only the recommendations of ORA witness Dawadi, and asserting that his recommended capital structures are not materially different from those proposed by the Applicants but have "the

[32] Exhibit SJ-02 (Lynch), at 11-13.
[33] SJWC Opening Brief, at 47-48; SJWC Reply Brief, at 22, 26-27.
[34] PD, at 25 (Finding of Fact 19).

advantage of being based on the actual capital structure of the companies' regulated operations and as such [providing] the most accurate capital risk profile on which to base adjustments to recommended ROE."[35] On that basis the Proposed Decision concludes that "Dawadi's method of establishing regulatory capital structures is reasonable and appropriate" and adopts the capital structures proposed by ORA.[36]

The Proposed Decision makes no mention at all of the Applicants' witnesses' testimony relating to capital structure, except to note generally that "ORA's recommended capital structures are not materially different from those proposed by the Applicants"[37] This is not true. For SJWC, ORA would impute a debt ratio of 47.42%, which is 0.70% higher than SJWC's projected debt ratio of 46.72%. Even applying the costs of equity and debt the Proposed Decision would adopt for SJWC (8.30% and 5.96%, respectively), the difference is 234 basis points. On that basis, applying SJWC's projected debt ratio of 46.72 would result in an overall rate of return of 7.206752%, or 7.21% following the rounding convention applied by the Proposed Decision.[38] This would be a rate of return two basis points higher than the 7.19% rate the Proposed Decision would allow. Contrary to the sentiment of the Proposed Decision, SJWC considers a difference of two basis points in its overall rate of return to be a material difference.

More fundamentally important, however, is that the ORA witness's method of calculating capital structures for the four Applicants is an unjustified deviation from a standard method for making such calculations that the Commission has employed for many years and that has not been shown deficient in any respect. That standard method is to set rates based on a forecast of future expense. As the Commission has often stated,

> [W]e base public utility rates on future test years . . . . The goal is to make reasonable estimates that will allow the utility the opportunity to earn a fair return on its rate base.[39]

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[35] PD, at 23.
[36] *Id.*
[37] PD, at 23, 25 (Finding of Fact 20).
[38] 0.5328 x 0.0830 + 0.4672 x 0.0596 = 0.07206752.
[39] *Re Valencia Water Co.*, D.07-06-024, at 39.

SJWC witness Lynch followed that standard method by taking account of SJWC's expected capital investments, dividend payments, retained earnings, and debt and equity issuances and retirements, in order to provide a reasonable forecast of SJWC's capital structure and cost of debt for the three-year forecast period for which the Commission's adopted costs of capital will apply.[40] ORA witness Dawadi based his recommended capital structure on each Applicant's historical capital structure as reported to the Commission for years 2013 to 2016, without any adjustment for future events. SJWC showed that the reasons Mr. Dawadi offered to support his unconventional approach were "either flawed or inconsequential or both."[41] SJWC witness Lynch expressly challenged Mr. Dawadi's reliance on recorded capital structures that did not reflect forecasted operating results, capital expenditures, dividend activity, or equity and debt offerings during the three-year period covered by this proceeding, and SJWC's opening brief emphasized the inconsistency of Mr. Dawadi's analysis with future test year ratemaking.[42] On reply brief, SJWC noted that the ORA witness "presented no Commission precedent or any other justification for seeking to impose unadjusted historical results for the three-year forecast period" and presented no reason for the Commission not to rely on SJWC's forecast.[43]

The cost of capital review being conducted in this proceeding is part of the general rate case process for Class A water utilities. That process relies on forecasted test years.[44] Witness Dawadi's reliance on ***unadjusted*** historical records to estimate capital structure for the three-year future period to which the adopted costs of capital will apply flies in the face of that basic principle of the Commission's ratemaking practice. For the Proposed Decision to adopt "Dawadi's approach" is inconsistent with all applicable Commission precedent and with the basic theory of future test year ratemaking. Mr. Dawadi's approach should not be adopted and the

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[40] See SJWC Opening Brief, at 36-38, referencing Exhibit SJ-01 (Lynch).
[41] SJWC Opening Brief, at 41-45.
[42] SJWC Opening Brief, at 41-42, referencing Exhibit SJ-02 (Lynch).
[43] SJWC Reply Brief, at 21, referencing Exhibit SJ-02 (Lynch).
[44] *See, Rulemaking to Revise the General Rate Case Plan for Class A Water Companies*, D.04-06-018, at 6 ("Standard ratemaking practice uses "test year" to refer to the period over which the cost of service and proposed rates will be evaluated. . . . The Commission's current practice for water utilities is to use two forecasted test years.")

Proposed Decision should be modified to substitute the capital structures proposed by SJWC (46.72% debt/53.28% equity) and the other Applicants.

VI.

CONCLUSION

For all the reasons stated above, San Jose Water Company respectfully urges the Commission not to adopt the Proposed Decision of ALJ Bemesderfer without substantial changes. In particular, SJWC urges the Commission to adopt an ROE for SJWC not lower than 9.43% and to approve a 6.20% cost of debt and a 46.72% to 53.28% debt-to-equity ratio for SJWC for the years 2018 through 2020, as calculated and proposed by SJWC witness Lynch. SJWC also requests that the Commission include in its adopted decision the revised Findings of Fact and Conclusions of Law set forth in Appendix A to SJWC's comments.

Respectfully submitted,

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APPENDIX A

Proposed Findings of Fact and Conclusions of Law

Proposed additions are shown by underlining and proposed deletions by ~~strike-throughs~~.

Findings of Fact

1. More than 400 ~~ratepayers~~ customers ~~appeared at~~attended the PPHs and more than 100 of them provided comments.

. . .

6. The 10.75% to 11.00% ROEs requested by Applicants are more than 100 basis points higher than the national average ROEs granted water utilities and approximately 70 basis points higher than the major California energy utilities' ROEs but are in line with the ROE recently granted to small telecommunications utilities.

6a. The 8.22% to 8.30% ROEs recommended by ORA are more than 100 basis points lower than the national average ROEs granted water utilities and almost 200 basis points below those recently allowed to the major California energy utilities.

. . .

8. ~~The parties~~Applicants used variations of the CAPM, RPM and DCF financial models to support their respective ROE recommendations.

8a. ORA used a version of the DCF financial model that presumed water utilities would grow earnings consistent with forecasts of 11% to 12% despite ORA's much lower ROE recommendations, while applying a purported CAPM analysis that merely averaged Value Line forecasts for 30 companies, none of which were utilities.

. . .

17. ~~ORA's recommended returns on equity range from 8.22% to 8.30%.~~ ORA alleged that balancing accounts and rate adjustment mechanism shifted risks away from utilities to consumers, justifying lower ROEs but failed to compare those mechanisms available to Applicants with comparable mechanisms available to California energy utilities or to water utilities in other jurisdictions.

17a. ORA alleged that only non-diversifiable risks were relevant to water utilities' cost of equity as a reason not to grant company-specific risk premiums.

18. Applicants' costs of debt as calculated by ORA range from 5.22% to ~~5.40~~6.40%.

19. ~~After elimination of double-counted costs,~~ ORA's calculated costs of debt ~~are not materially different from those proposed by Applicants~~improperly exclude early redemption costs that Applicants properly incurred and accounted for and are affected by other errors.

19a. With appropriate corrections, ORA's calculation of SJWC's cost of debt matched SJWC's proposed cost of debt of 6.20%.

20. ORA's recommended capital structures were based on unadjusted historical amounts, while those ~~are not materially different from those~~ proposed by Applicants reflect expected capital investments, dividend payments, retained earnings, and debt and equity issuances and retirements.

Conclusions of Law

. . .

3. ~~Applicants provided no reason to consider t~~The average ROE of the national water utilities ~~or~~ and the ROEs recently granted to major California energy utilities and small telecommunications utilities should be considered as ~~an~~ reasonable ROE benchmarks in this proceeding.

. . .

5. Non-regulated comparable earnings financial modeling results, including ORA's CAPM analysis, should not be considered in this proceeding for the reasons set forth in the body of this decision.

. . .

9. Neither Applicants nor ORA~~did not~~ provided any evidence to substantiate that they are either riskier or less risky than either the national water utilities or the major California energy utilities.

10. A 2018, 2019 and 2020 ROE range from ~~7.40~~9.43% to ~~9.40~~10.05% is just and reasonable for CAW, CWS, GSW and SJW.

. . .

14. A~~n 8.30~~ 9.43% ROE for the 2018, 2019 and 2020 calendar year is just and reasonable for SJW.

15. ORA's recommended costs of debt for CAW, ~~CWS,~~ GSW and SJW are unreasonably low due to excluding appropriately incurred early redemptions costs and other errors ~~reasonable~~ and should be not be adopted.

15a. SJW's proposed cost of debt of 6.20% should be adopted.

16. ORA's recommended capital structures for CAW, CWS, GSW and SJW are based on an unreasonable reliance on unadjusted historical amounts and should not be adopted.

16a. SJW's proposed capital structure of 46.72% debt/53.28% equity should be adopted.

. . .