

Decision 03-07-013 July 10, 2003

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of SAN JOSE WATER COMPANY (U-168-W) to borrow funds under the Safe Drinking Water State Revolving Fund and to add a surcharge to water rates to repay the principal and interest on such loan.

Application 03-02-010
(Filed February 4, 2003)

**OPINION ON BORROWING SAFE DRINKING WATER FUNDS AND
REPAYMENT OF SUCH FUNDS THROUGH A SURCHARGE**

I. Summary

This order authorizes San Jose Water Company (SJW) to enter into a loan contract with the Department of Health Services (DHS) and the Department of Water Resources (DWR) for the purpose of borrowing \$2,474,000 from the Safe Drinking Water State Revolving Fund (SDWSRF). The loan proceeds shall be used only to finance the design and construction of facilities at the Montevina Water Treatment Plant (Montevina plant) of SJW for recovery and storage of high turbidity water¹ that cannot be treated quickly enough to meet California's Interim Enhanced Water Treatment Rule (IESWTR).

¹ Turbidity is a measure of the cloudiness of water. It is used to indicate water quality and filtration effectiveness. Higher turbidity levels are often associated with higher levels of disease-causing microorganisms such as viruses, parasites and some bacteria.

SJW is also authorized to impose a temporary surcharge to repay the loan. The surcharge for a typical residential customer with a $\frac{3}{4}$ inch meter would be \$0.05 per month, an increase in the average monthly bill of approximately 0.14%.

II. Background

SJW supplies domestic water to a population of approximately one million residents through approximately 212,000 service connections. It serves the cities of Campbell, Saratoga, Monte Sereno, the Town of Los Gatos, portions of the cities of San Jose and Cupertino, and in the adjacent territory within the County of Santa Clara. SJW provides uninterrupted access to a supply of water through several facilities, including its Montevina plant.

The Montevina plant serves approximately 100,000 people in the communities of Los Gatos, Monte Sereno, Saratoga, Campbell, and San Jose. It is located at the base of the Santa Cruz Mountains in Santa Clara County. Its source of supply is runoff water from winter storms that is treated at the plant to remove contaminants and filtered to achieve visible clarity. After treatment, the water is stored on site or put immediately into a distribution system.

Effective January 1, 2002, the acceptable level of filtered surface water turbidity was lowered to one nephelometric turbidity unit (NTU) from five pursuant to California's IESWTR. Because the Montevina plant exceeded one NTU 30 times in the two years prior to effective date of IESWTR, SJW was required to either divert "off-spec" water, water that cannot meet the revised NTU standard, to an off-line basin for reprocessing or shutdown its Montevina plant each time the plant failed to comply with the revised NTU standard.

To avoid shutting down the plant and to ensure that its 100,000 customers being served by that plant continue to have uninterrupted access to a supply of water, SJW determined that it needed to construct an off-spec water diversion at

the Montevina plant. That diversion would involve dividing the existing 2.9 million gallon portable water storage basin at Montevina with a structural concrete wall, and installing pumps, pipe works, valves and controls necessary to operate the process. The remaining half of the basin would continue to be used as clear-well storage.

On September 8, 2000, SJW applied for a SDWSRF loan to finance the design and construction of its off-spec water diversion project (Project No. 4310011-07). SDWSRF loans are low interest loans provided in part from a Federal Capitalization Grant for Drinking Water State Revolving Fund (California). Pending approval of that loan from DHS and DWR,² SJW advanced the funds necessary to begin the project from its treasury so that it could avoid missing the IESWTR regulatory deadline driving the project by more than one year. On July 23, 2002, the project was completed. Approval of the SDWSRF loan was still pending. This project is not included in SJW's current rates, the costs of which are being finalized.

DHS concurred with SJW that an off-spec diversion should be constructed. DHS also monitored the progress of the project throughout its planning, design and construction to ensure compliance with all SDWSRF rules.

Subsequently, DWR issued a December 17, 2002 letter of commitment to SJW for a \$2,474,000 SDWSRF loan to be repaid over a 20-year term with a 2.39% annual interest rate. DWR conditioned its loan approval upon SJW obtaining

² DHS is responsible for determining whether the proposed project meets water quality standards. DWR is responsible for assessing the utility's financial need to meet the water quality standards and ability to meet the loan obligations. DWR also acts as the lending agency and fiscal administrator of the loan.

Commission approval and Commission authorization to impose a customer surcharge for repayment of the loan.

III. Discussion

SJW seeks Commission approval to enter into a SDWSRF loan and Commission authorization to establish a customer surcharge to repay that loan.

A. Loan Approval

Article 5 of the Public Utilities Code sets forth conditions a public utility must satisfy to enter into a loan agreement.³ One condition is that the loan be for a permitted purpose listed in Section 817. Among the permissible purpose applicable in this instance is for the construction, completion, or extension of improvement of utility facilities. (Section 817(b).) The construction of an off-spec water diversion at the Montevina plant, being a necessary capital addition to satisfy IESWTR and other DHS minimum water quality standards, is for the public good, and thus qualifies under this provision.

Another permissible purpose is for the reimbursement of money actually expended from the treasury of a public utility not secured by or obtained from the issuance of stocks, stock certificates, other evidence of interest or ownership, bonds, notes, or other evidence of indebtedness of a public utility. (Section 817(h).) SJW's use of its own treasury funds, not part of any stock or other debt proceeds, and not part of any cost recovery in current rates, meets this description. Thus, the loan is also within the permitted purpose of evidence of indebtedness.

³ All statutory references are to the Public Utilities Code unless otherwise stated.

A second condition is that a public utility first secure from the Commission an order authorizing the debt, stating the amount thereof and the purpose to which the proceeds thereof are to be applied, and that, in the opinion of the Commission, the money to be procured is reasonably required for the purposes specified in the order, such purposes not reasonably chargeable to operating expenses or to income. (Section 818.) SJW, not yet signing the debt instrument, and the loan being conditioned upon SJW obtaining prior Commission approval, has satisfied this condition.

SJW has satisfied the statutory conditions granting it the necessary authority to borrow \$2,474,000 to reimburse SJW for improvements determined by DHS to be necessary to meet water quality standards at the Montevina plant. SJW should be authorized to execute a note and related security instruments with the DHS and DWR for the proposed loan.

B. Surcharge

Section 454 governs the conditions upon which a customer surcharge may be established. Those conditions are that a public utility must present a showing for the surcharge and the Commission must find that the surcharge is justified.

SJW estimates that it will need \$85,984 semi-annually or \$171,968 per year for the first ten years, and \$78,167 semi-annually or \$156,334 annually for the last ten years of the \$2,474,000 loan to make principal and interest payments throughout the 20-year loan term.

SJW based its customer surcharge on individual meter sizes. A component of that surcharge included a reserve to establish and maintain a reserve fund at a level that accumulates a reserve equal to two semiannual loan payments during the first ten years, to comply with DWR regulations.

The surcharge for a typical residential customer with a ¾-inch meter for the first ten years would be \$0.05 per month, an increase in the average monthly bill of about 0.14%. The surcharge would be separately identified on each customer's bill. A detailed surcharge schedule by individual ¾-inch to 10-inch meter size is set forth on page six of the application.

SJW also proposes to establish a balancing account to be credited with revenues collected through the surcharge and to be charged with payments of principal and interest on the loan. It also proposes to adjust the surcharge periodically by advice letter to reflect changes in the number of connections and any excessive over- or under-collections in the balancing account.

To assure the availability of funds to repay the loan, SJW proposes, within 30 days after collection from customers, to deposit all rate surcharge revenue with a fiscal agent approved by DWR. SJW also proposes to exclude the surcharge revenue and utility plant financed through the surcharge from rate base for ratemaking purposes.

SJW has justified its proposed surcharge, as required by Section 454. It is also in the public interest to authorize SJW to establish a surcharge as proposed in its application. However, SJW should retain all invoices related to the Montevina plant off-spec water diversion project financed by the SDWSRF loan so that Water Branch or other Commission Division may confirm that the loan was properly used for the stated purpose and reimbursable through a customer surcharge. SJW should also maintain adequate records to enable the Water Branch or other Commission Division to audit the reasonableness of the surcharge, revenues collected through the surcharge, and payments of principal and interest on the loan.

IV. Procedural Matters

SJW requested that this matter be categorized as ratesetting and states that no hearings are necessary. By Resolution ALJ 176-3108, dated February 27, 2003, the Commission preliminary determined that this was a ratesetting proceeding and that no hearings were expected.

Notice of the application appeared in the Commission's February 14, 2003 Daily Calendar. Customers were notified of this application, pursuant to Rule 24 of the Commission's Rules of Practice and Procedures (Rules). There is no objection to the ratesetting categorization of this application and there were no protests to the application. A hearing is not necessary.

V. Comment Period

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Pub. Util. Code § 311(g)(3), the otherwise applicable 30-day period for public review and comment is being waived.

VI. Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and Michael J. Galvin is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. SJW's Montevina plant serves approximately 100,000 people in the communities of Los Gatos, Monte Sereno, Saratoga, Campbell, and San Jose.
2. The source of supply for the Montevina plant is runoff water from winter storms.
3. The acceptable level of filtered surface water turbidity was lowered to one NTU from five NTU effective January 1, 2002.
4. The Montevina plant exceeded one NTU 30 times in the two years prior to the effective date of the one NTU standard.

5. SJW applied for a SDWSRF loan to finance its off-spec water diversion project on September 8, 2000.

6. SJW advanced the funds necessary to construct an off-spec water diversion at its Montevina plant from its treasury so that it could avoid shutting down the plant during the periods of time it exceeded the NTU standard.

7. The Montevina plant off-spec project cost is not included in rates.

8. The Montevina plant off-spec project was completed on July 23, 2003.

9. DWR issued a letter of commitment to SJW for its requested SDWSRF loan on December 17, 2002 conditioned upon Commission approval of the loan and Commission authorization for a customer surcharge to repay the loan.

10. There are no filed protests to this application.

Conclusions of Law

1. Approval of the SDWSRF loan agreement for the off-spec water diversion project at the Montevina plant and approval of a customer surcharge to repay the loan is in the public interest and is otherwise proper pursuant to applicable provisions of the Public Utilities Code.

2. SJW should retain invoices for the work completed and maintain adequate records to enable an audit be conducted on the reasonableness for the surcharge, revenues collected through the surcharge, and payments of principal and interest on the loan.

3. SJW should pay the fee determined in accordance with Section 1904(b) of the Public Utilities Code.

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

O R D E R

IT IS ORDERED that:

1. San Jose Water Company (SJW) is authorized pursuant to Section 816, et seq. of the Public Utilities Code, to issue evidence of indebtedness in an amount not to exceed \$2,474,000 and to grant a security interest in its assets for capital expenditures within its Service Area. A copy of the promissory note and loan contract agreement shall be filed with the Water Division within 15 days after execution.

2. SJW shall retain all invoices related to the Montevina plant off-spec water diversion project financed by the Safe Drinking Water State Revolving Fund loan so that Commission staff may confirm that the loan was properly used for the stated purpose and reimbursable through a customer surcharge.

3. SJW shall maintain adequate records to enable Commission staff to audit the reasonableness of the surcharge, revenues collected through the surcharge, and payments of principal and interest on the loan.

4. SJW is authorized to file an Advice Letter imposing a surcharge on its customers to repay the indebtedness authorized in Paragraph 1 of this order.

5. On or before July 31, 31, 2004, and yearly thereafter, for as long as the surcharge is imposed, SJW shall send a comparative report to the Water Division stating the changes in the number of connections by type of customer and by size of connection, the amount of surcharge collected, the amount of repayments made, the outstanding balance of the loan, and the overages and shortages in SJW's balancing account. SJW shall also indicate in the report if an advice letter will be forthcoming to reflect changes in the rate surcharges.

6. SJW shall pay a \$3,474 fee as required by Section 1904(b) of the Public Utilities Code.⁴

7. Application 03-02-010 is closed.

This order is effective today.

Dated July 10, 2003, at San Francisco, California.

MICHAEL R. PEEVEY

President

CARL W. WOOD

LORETTA M. LYNCH

GEOFFREY F. BROWN

SUSAN P. KENNEDY

Commissioners

⁴ The amount subject to the fee is \$2,474,000. The fee is determined as follows: (\$2 times (1,000,000/1,000)) plus (\$1 times \$1,474,000) equals \$3,474.