



PUBLIC WORKS DEPARTMENT

CITY HALL

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CITY COUNCIL STAFF REPORT

Meeting: September 6, 2016

Subject

Consideration pursuant to a Lease with San Jose Water Company, of the reasonableness of an increase in water rates to customers served by the Cupertino Municipal Water System leased to San Jose Water Company. The increase in rates is substantially identical to that authorized by the California Public Utilities Commission ("CPUC"), after extensive review, for systems owned and operated by San Jose Water Company in other areas within the City.

Recommended Action

1. Hold a Public Hearing on proposed Cupertino Municipal Water System potable water rates and charges; and
2. Adopt Resolution 16-___, finding no basis to find as unreasonable the increase in Cupertino Municipal Water System potable water rates and charges, effective September 15, 2016 and retroactive to January 1, 2016, by 8.6% which is equivalent to the rate increase authorized by the California Public Utilities Commission ("CPUC"), after extensive review for systems owned and operated by San Jose Water Company in other areas within the City. (Attachment A)

Background

There are three water service areas in Cupertino (Attachment B). One area (shown in green) is served by a water system owned and operated by San Jose Water Company (SJWC), one area (shown in purple) is served by a water system owned and operated by California Water Service Company, and one area (shown in blue) is served by the Cupertino Municipal water system that is owned by the City of Cupertino but is leased for operations by SJWC.

The Cupertino Municipal Water System was leased to SJWC in October 1997 for a term of twenty-five (25) years. As the lessee of the Cupertino Municipal Water System, SJWC is responsible for all operations of the system including repair, maintenance, operation, customer service/billing, emergency service and water quality testing. Furthermore, SJWC has the responsibility to operate the Cupertino Municipal Water System in a manner similar to that in which it operates its own systems and to maintain the Cupertino

Municipal Water System in accordance to customary utility standards.¹ The responsibilities of SJWC and the City, as the lessee and lessor respectively, are available for review in the 1997 Agreement for Lease of Real Property (Water System) (“Lease”) (Attachment C).

Water rates and charges proposed for privately owned water systems - such as those owned and operated by California Water Service Company or SJWC, are regulated by the CPUC. Rates charged for service for the Cupertino Municipal Water System are not subject to CPUC regulation. Under the Lease, SJWC shall propose to City reasonable rates and charges that SJWC will charge for water service to be delivered to the customers served by the Cupertino Municipal Water System. After receipt of a SJWC request for an increase in rates, the City either approves or denies the increase or takes no action at all. The City may not unreasonably withhold approval of the increase in rates requested by SJWC. If the City does not act on a SJWC requested increase within 60 days, the amount of that increase would be recovered at such time as any increase is approved in the future; the effect is to place SJWC in the same position it would be in had the City approved the requested increase within a 60 day period. Accordingly and in practice, the request is considered acceptable and SJWC receives the requested rate increase amount. To date, SJWC rate increase requests have occurred without the City taking action and have been equal to the charges that SJWC sets to its own customers where SJWC owns and operates the water system.

This approach has worked well for the City for two reasons. First the CPUC subjects any proposed rate increase by SJWC to a level of scrutiny and review that the City would have difficulty replicating; since SJWC is a Class A water utility its major rate applications are, as noted below, reviewed by a team of accountants, engineers and attorneys in the CPUC’s Office of Ratepayer Advocates (“ORA”), a statutorily² created staff division charged with protecting ratepayer interests. The second reason is the average annual rate increase authorized by the CPUC to date has been similar to the general rate of inflation. The table below shows the CPUC authorized rate increases from 2005 through 2016 to customers of water systems owned by SJWC. Similar adjustments were made to the rates for the Cupertino Municipal Water System leased to SJWC.

¹ SJWC provides potable water service to over one million customers in the greater San Jose area. The water system leased to SJWC includes approximately 4100 Cupertino customers.

² Section 309.5(a) of the Public Utilities Code provides that:

There is within the commission an independent Office of Ratepayer Advocates to represent and advocate on behalf of the interests of public utility customers and subscribers within the jurisdiction of the commission. The goal of the office shall be to obtain the lowest possible rate for service consistent with reliable and safe service levels. For revenue allocation and rate design matters, the office shall primarily consider the interests of residential and small commercial customers.

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
2.70%	2.60%	2.00%	3.00%	2.20%	9.20%	3.40%	4.90%	9.80%	5.20%	2.80%	8.6%

Other rate changes/surcharges have also occurred and are generally considered “pass-through” and charged at cost.

While the CPUC process has remained the same, a variety of factors, including but not limited to increases arising from water sales adjustment surcharges caused by the current four year drought, contribute to the current 2016 SJWC request and CPUC authorized increase amount of 8.6% being considered and brought to Council for consideration now.

Analysis

In determining if the 8.6% increase in water rates and charges requested by SJWC for 2016 is reasonable, the City should consider all relevant information. This information has been identified as (a) the rate setting process and findings of the CPUC; and (b) the comparable water rates of similar nearby municipalities; and (c) stakeholder and public input.

The CPUC Process and Findings

The CPUC review and authorization process applies to all California investor-owned water utility companies. The purpose of the process is to ensure that each regulated utility delivers clean, safe, and reliable water to their customers at reasonable rates. SJWC is 1 of 9 large water utilities regulated by the CPUC.³ There are a total of 108 investor-owned water utilities under the CPUC’s jurisdiction providing retail water service to about 16 percent of California’s residents. The CPUC is a constitutionally created body consisting of five Commissioners appointed by the Governor. It employs a staff of over 1,000 which include a staff of experts, engineers, statisticians, accountants, attorneys and administrative law judges.

Rate and revenue requirement requests received by the CPUC are categorized one of two ways. The first is referred to as a general rate case (GRC) increase request wherein an operator of a water system is required to submit to the CPUC a three-year look ahead. In this three-year look ahead, water utilities identify costs other than pass through that are either occurring or anticipated to occur within a subsequent three-year time period. Costs due to operation, maintenance and needed physical improvements are typically included in GRC requests. Due to the often complex nature of the costs requested by the water utility, the review and authorization process of GRC requests by the CPUC are lengthy in time and process. For this reason, GRC requests are typically submitted to the CPUC by the water retailer up to 1-year in advance. This allows the CPUC staff the opportunity to evaluate costs and to consider customer input at public hearings well in advance of the proposed rates being authorized and implemented to the customer. For the most recent

³ Large water companies are also known as “Class A” companies and serve more than 10,000 connections.

GRC submitted by SJWC to the CPUC in January 2015 (for the 3-year period beginning January 2016 through December 2018) the review and authorization process was not completed until June 2016.

When rate and revenue requirements requests are pass-through in nature, water utilities submit to the CPUC an Advice Letter. Multiple advice letters may be submitted in any one year. Unlike the costs that may be included by private water utilities in a GRC application, advice letter rate increases are generally authorized by the CPUC in less time and by less process because they are increases in costs not controlled by the water utility. Examples of pass through costs include increased wholesale water costs, increased electrical costs and surcharges due to drought conditions. Per the provisions of the agreement between the City and SJWC, previous pass through expenses to customers served by the Cupertino Municipal Water System have occurred without the City taking action and have been equal to the charges that SJWC sets to its own customers where SJWC owns and operates the water system.

Within the CPUC there is an independent Office of Ratepayer Advocates (ORA), also comprised of professionals, which represent and advocate on behalf of the interests of private utility customers served by large water companies. For every GRC request and advice letter request⁴ submitted, the ORA scrutinizes the costs of each large water company service and then makes recommendations to the CPUC regarding the merits of each requested change in cost. The ORA, in completing their work and achieving their goal of obtaining the lowest possible rate for service consistent with reliable and safe service levels, primarily considers the interests of residential and small commercial customers when making their recommendation.

On June 9, 2016, upon consideration of a significant amount of evidence submitted in support of the SJWC rate increase and various public hearings, the CPUC issued its final decision (<http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M163/K202/163202231.pdf>) of an 8.6% increase for 2016 retroactive to January 1, 2016. SJWC had requested a 12.22% increase. Reasons cited by the CPUC/ORA for the reduction was in part due to a recommended delay in purchases and reduced contingency factors. SJWC notified its customers about this rate increase and provided additional information about it on their website.⁵

⁴ Some advice letter requests are reviewed by a different staff division, the Water Division.

⁵ See <https://www.sjwater.com/news/topic/2016-water-rates-frequently-asked-questions>.

The CPUC has not yet authorized the SJWC requested rate increases of 3.11% in 2017 and 5.36% in 2018. As these or similar increases are likely to occur in 2017 and 2018, Council consideration and the opportunity for affected customers to have input will be recommended.

Anticipating the CPUC authorization, SJWC submitted a request to the City for a water rate increase for Cupertino Municipal Water System customers for the year 2016 on April 28, 2016. This request is included in this report. (Attachment D).

Because the requested increase for Cupertino Municipal Water System customers is the same as those served directly by SJWC, staff has reviewed the documentation submitted to the CPUC in support of the request as well as the materials prepared by the CPUC/ORCA in establishing the rate. This rate-setting application and evaluation process was exhaustive. Staff believes the need for a rate increase is supported by the evidence presented, which demonstrate the SJWC's costs of providing the service meet or exceed the requested increase.

Comparison with Other Water Rates

Other cities and water agencies within Santa Clara County have recently authorized water rate increases, as shown below. Additionally, the CPUC has authorized water retailers such as California Water Service Company and SJWC to implement a surcharge to customers who use more water than the customer's 2013 baseline amount. Customers served by the Cupertino Municipal water system are subject to this surcharge. Attachment E shows how the drought surcharges are calculated.

City / Water Agency	2015-2016 Monthly Bill	Increase Authorized / (Proposed)	2016-2017 Monthly Bill
California Water Service Co. / Los Altos)	\$76.72	16.5%	\$83.13 ¹
SJWC	\$83.54	(8.6%)	\$90.26 ²
Sunnyvale	\$72.37	25%	\$72.41 ³
Mountain View	\$94.93	9.9%	\$104.48 ¹
Santa Clara	\$75.40	19%	\$88.55 ¹

1 Effective July 1st.

2 Retroactive to January 2016. Actual increase varies by level of service, customer class and meter charges.

3 Effective July 1st. Actual increase varies by level of service, customer class and meter charges.

For water usage of 15 hundred cubic feet (11,220 gallons) per month with a 5/8 x 3/4-inch meter.

As can be seen from this comparison, the rates proposed by SJWC are within a reasonable range of comparable agencies and service providers.

Stakeholder and Public Input

During the week of July 11th, approximately 4500 written notices were mailed via U.S. mail to customers and property owners served by the Cupertino Municipal Water System. The City also prepared a Frequently Asked Questions page for its website to help inform the public about this topic.⁶ At the writing of this report, approximately 21 emails and 7 phone calls have been received by staff in response. The notice, proposed rate schedule and log of correspondence is included in Attachment F. If needed, a supplemental memo will be submitted to City Council prior to the September 6th public hearing to report on any additional public comments received. To date, while there has been some concern expressed about the increase, the vast majority of customers have not expressed opposition to the request.

Staff Recommendation

In light of the information from the CPUC process, comparable rates, and public input, staff did not identify a basis to find unreasonable the 8.6% increase in Cupertino Municipal Water System potable water rates and charges, effective September 15, 2016 and retroactive to January 1, 2016. Staff recommends that the Council adopt the attached Resolution to fulfil its obligation under the Lease to act on SJWC's requests for rate increases.

Future Rate Changes

SJWC was instructed by the CPUC in the June 9, 2016 CPUC decision to file an advice letter for years 2017 and 2018. The filings, provided they are submitted by SJWC to the CPUC, are to include proposed new revenue requirements, all supporting work papers and the corresponding revised tariff schedules. Assuming that the CPUC authorizes the filings, the revised tariff schedules for water systems owned by SJWC could take effect as early as January 1, 2017 and January 1, 2018, respectively. If, on the other hand, the CPUC finds that the 2017 and 2018 revised rates are not conforming to the January 2015 GRC submitted for years 2017 and 2018, the SJWC advice letter filing is likely to be rejected or amended by the CPUC.

At this time it is not known if the requested increased rate amounts made by SJWC to the CPUC of 3.11% for 2017 and 5.36% for 2018 will be changed and/or authorized by the CPUC in the future. That being stated, it is likely that SJWC will request the City consider additional rate increases as high as 3.11% for 2017 and 5.36% for 2018 in the near future.

⁶ Available online at <http://www.cupertino.org/Modules/ShowDocument.aspx?documentid=12055>.

We will process future rate increases as required by the terms of the Lease and applicable law. All customers of the Cupertino Municipal water system would receive written notice prior to the public hearing.

Fiscal Impact

Per the provisions of the agreement between the City and SJWC, all monies for services rendered by SJWC are the property of SJWC. Accordingly, there is no fiscal impact to the City regarding a change in rates to customers of the Cupertino Municipal water system.

Customers of the Cupertino Municipal Water System would see their rates increase 8.6% more per month beginning September 15, 2016. A retroactive rate increase for the period from January 1, 2016, through September 15, 2016, equivalent to 8.6% would also be incurred and collected by SJWC over a period to be determined.⁷

Prepared by: Roger Lee, Assistant Director of Public Work

Reviewed by: Timm Borden, Director of Public Works

Approved for Submission by: David Brandt, City Manager

Attachments:

A - Resolution 16-____

B – Water Boundary Map

C - 1997 Agreement for the Lease of Real Property-Water System

D – April 28, 2016 SJWC Request for Water Rate Increase for Cupertino Municipal Water System with Proposed Rate Schedules

E - Drought Surcharge Calculation

F – Notice to Customers Served by the Cupertino Municipal Water System and Correspondence Log

⁷ For water usage of 15 hundred cubic feet (11,220 gallons) per month with a ¾-inch meter.