BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

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Order Instituting Rulemaking on the Commission's Own Motion into Addressing the Commission's Water Action Plan Objective of Setting Rates that Balance Investment, Conservation, and Affordability for the Multi-District Water Utilities of: California-American Water Company (U210W), California Water Service Company (U60W), Del Oro Water Company, Inc. (U61W), Golden State Water Company (U133W), and San Gabriel Valley Water Company (U337W).	Rulemaking 11-11-008 (Filed November 10, 2011)

OPENING COMMENTS
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I. INTRODUCTION

On November 10, 2011, the California Public Utilities Commission (Commission) opened an Order Instituting Rulemaking (OIR) to address the sixth objective of the Commission's 2005 Water Action Plan, *i.e.*, to set rates that balance investment, conservation, and affordability, by considering policies and mechanisms that serve to subsidize high cost areas, such as rate consolidation within multi-district water utilities and the potential development of a water "High-Cost" fund.[1] The Division of Ratepayer's Advocates (DRA) is a named respondent to the rulemaking, as are the following water utilities: California-American Water Company, California Water Service Company, Del Oro Water Company, Inc., Golden State Water Company, and San Gabriel Valley Water Company.[2]

The OIR recognizes that although the Commission traditionally sets rates on a district-by-district basis, it has made exceptions to this approach by approving rate consolidation across multiple districts, or via the implementation of single tariff pricing, in several instances.[3] As explained in the OIR, in 1992, DRA and the Class A water utilities jointly developed a set of policy guidelines to be considered in evaluating rate consolidation proposals (1992 Guidelines). The OIR states that as a result of the rulemaking, the Commission may revise the 1992 Guidelines or adopt new consolidation guidelines for high-cost areas.[4] Further, the OIR contemplates that the rulemaking may also result in the adoption of new guidelines for the establishment of water "High-Cost" funds.[5]

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[1] R.11-11-008, p. 1, 4.

[2] *Id*. at 17.

[3] *Id*. at 5.

[4] *Id*. at 7.

[5] *Id*. at 7-8.

In order to inform the Commission's decision making process, the OIR orders DRA and the water utilities identified above to file comments in response to eight questions and requests for information. In response to the OIR, DRA submits the following explanatory comments and answers to the enumerated questions.

II. SUMMARY

For many small and/or lower income water districts,[6] affordability of water service is a growing concern. The water industry is a rising cost industry, one faced with increasing costs over the next several decades as it attempts to comply with new water quality regulations and replace aging drinking water infrastructure. As the Commission noted in D.00-06-075, "[i]n terms of capital investment for revenue dollar, the provision of water service is the most capital intensive public utility service."[7] The affordability of water service is a growing concern for water customers across the state. These systems have limited opportunity to distribute the cost burden of the required new investments in infrastructure since smaller systems must recover revenue requirements over a smaller customer base. Required new investment could more than double a household water bill in a small district. Household bills are often high already and, in some districts, a majority of the customers are low-income, leaving few other households to shoulder the burden.

Affordable water has been defined as monthly water bills that do not impose undue economic hardship on low or fixed-income households in the service area. Water rates should be low enough so that low-income customers will not have to forego other essential services (food, energy, medical care, etc.) to pay their water bills.[8] Affordability

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[6] The multi-district investor owned Class A Water utilities are divided into localized water districts for operational and ratemaking purposes. Utilities alternately refer to these local government entities as service districts, Community Service Areas (CSAs), or service territories. Notably, there is often more than one water system in a given district. For ease of reference, DRA's comments refer to these local government entities as "water districts" or "districts."

[7] D.00-06-075, p. 27.

[8] Raucher, Bob, Presentation on "Affordability of Water Service" to the NAWC Annual Conference in

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is a function of both the price of water service, the quantity of water consumed, and the ability of households to pay for that service. Several policy options are available to address the problem of ensuring water is affordable for water service ratepayers. Options include the gradual phase-in of rate increases, single-tariff pricing, tiered rate designs, budget based water rates, public interest grants and loans, special payment arrangements, water conservation and low-income customer assistance programs.[9] The question is which solution or solutions best serves the public interest in a given case?

The Commission has established an objective in its Water Action Plan to set rates that balance investment, conservation, and affordability. In these comments, DRA responds to the questions on water district rate consolidation and the possible use of a High-Cost fund for water. First however, DRA provides some general comments on how rates for investor owned water utilities in California are set, and how consolidated rates, or single tariff pricing, differs. DRA then summarizes some of the general advantages and disadvantages of single tariff pricing.

Next, DRA offers a brief background and history of the use of telecommunications High-Cost funds in California, describes problems encountered with these programs, and explains why similar programs would not make sense for the water industry. DRA then summarizes some of the differences between the provision of water service, and other utility services such as telecommunications or energy.

Finally, DRA elaborates on the California Water Service ("CWS") Rate Support Fund, and makes recommendations regarding questions and criteria that the Commission should consider in workshops in order to develop guidelines for increased use of this type of fund, especially for the large multi-district utilities.

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Palm Springs, California, October 13, 2004.

[9] In addition, as prescribed by all water utilities' Rule 15, the utility tariff for main extensions, required contributions and advances for serving new developments ensure that existing water customers are not burdened with the cost of constructing new facilities to serve new customers.

III. BACKGROUND AND CONTEXT

A. How are rates in California set now?

For Class A investor-owned water utilities in California water rates are set by districts. Elevation, climate, physical terrain, the age of the infrastructure, the density of the service population and other factors all affect cost of service. According to a joint publication of the United States Environmental Protection Agency (EPA) and the National Association of Regulatory Utility Commissioners (NARUC), *Consolidated Water Rates: Issues And Practices In Single Tariff Pricing* (EPA/NARUC Report), "[d]ifferences in the proximity to water sources, the type of source (surface water versus groundwater), the quality of the source water, and implemented treatment methods will tend to produce substantial cost differences."[10] With these factors differentiating districts, the Class A investor-owned water utility districts tend to represent geographic clusters of customers with similar cost characteristics. Because of this similarity, and unlike other utility industries, rates are determined by district and each district in an investor-owned water utility undergoes a general rate case review every three years.

B. How do consolidated rates or single-tariff pricing differ from district rates?

According to the EPA/NARUC Report, "[c]onsolidated rates or single-tariff pricing is the use of a unified rate structure for multiple water (or other) utility systems that are owned and operated by a single utility, but that may or may not be contiguous or physically interconnected."[11] All customers pay the same rate for service even though

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[10] *Consolidated Water Rates: Issues and Practices in Single-Tariff Pricing*, A Joint Publication of the U.S. Environmental Protection Agency and the National Association of Regulatory Utility Commissioners, September 1999, p. 13, *available at* http://www.epa.gov/ogwdw000/utilities/stptitle.pdf (stating, "[t]he purpose of this report is to provide policymakers and other stakeholders with an overview of consolidated ratemaking and an appreciation of the complex trade-offs involve in its implementation. The report provides a review of historical, theoretical, and practical issues related to consolidated ratemaking, implementation data, and key decisions by the state public utility commissions.") (referred to below as "EPA/NARUC Report").

[11] *Id.* at 1 (explaining, "[t]he purpose of this report is to provide policymakers and other stakeholders with an overview of consolidated ratemaking and an appreciation of the complex trade-offs involve in its

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individual systems may vary in terms of the number of customers served, elevation, climate, physical terrain, the age of the infrastructure, the proximity to water sources, the type of source, the quality of the source water, and implemented treatment methods. Single tariff pricing aggregates costs and averages them over a broader customer base.

C. What are the advantages of rate consolidation?

Single tariff pricing or consolidated rates have both advantages and disadvantages. When properly structured consolidated rates may promote rate and revenue stability, improved affordability for customers of small systems, and protection against rate shock since costs are allocated over a broader customer base. The EPA/NARUC Report notes that, "[a] leading argument for single tariff pricing made by multi-system water utilities is that each individual system eventually will require an infusion of capital for renovations and improvements; only the timing varies. Equalizing rates smoothes the effect of discrete cost spikes across systems and over time, much like insurance pooling."[12]

D. What are the tradeoffs or disadvantages to single-tariff pricing?

A trade-off with other goals such as economic efficiency and cost-based ratemaking is required when implementing single-tariff pricing. The EPA/NARUC Report notes that the primary disadvantages of single-tariff pricing are that it undermines economic efficiency and distorts price signals and conflicts with traditional cost of service principles by breaking the link between cost and rates.[13]

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implementation. The report provides a review of historical, theoretical, and practical issues related to consolidated ratemaking, implementation data, and key decisions by the state public utility commissions.").

[12] *Id.* at 4.

[13] *Id*. at 5 (*citing* Steve H. Hanke, "On Water Tariff Equalization Policies," *Water and Engineering and Management*, 128 (August 1981), 33-34).

Economic theory argues for setting rates that are based on the true cost of providing service and ensuring that rates equitably allocate those costs. Cost-based rates send price signals that result in efficient resource use – matching supply with demand. Fair and equitable cost allocation suggests those who impose similar costs should pay the same rate, and those who impose different costs should pay different rates that reflect those cost differences.

The EPA/NARUC Report notes that some degree of cost averaging occurs in virtually all methods of utility rate design.[14] Single tariff pricing may result in an inappropriate level of subsidy or undue price discrimination where high-cost customers are subsidized at the expense of low-cost customers. Once consolidated rates are instituted in an area, it is hard to go back to disaggregated rates.

E. Existing California High-Cost Funds

High-Cost funds for telecommunications service were established to support universal service goals after the breakup of AT&T and the advent of local competition, which removed internal cross subsidies that kept basic phone rates low. The Commission has established two High-Cost funds to reduce disparity in rates charged by telephone companies. The larger of the two, California High-Cost Fund B, subsidize carriers for the difference between the computed statewide average cost of providing basic telephone service and the proxy cost for a given area. The subsidy is paid to the carrier. The program funding comes from a surcharge on *all* telecommunications customers except those on the Lifeline program, and is adjusted periodically.

Because investor owned water utilities continue to exist as monopolies in their respective service territories, and the provision of water service differs markedly from providing telecommunications service (as described in the next section), there is no comparable justification for the establishment of High-Cost funds to subsidize the cost of water service.

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[14] *Id*. at 19.

Further, DRA notes that just because water is high cost does not make it unaffordable – affordability is not only a function of the price of water service but also depends on the quantity of water consumed and the ability of households to pay for that service. Thus, high-cost water service in a high-income area would probably not be considered unaffordable.

If ratepayers are going to subsidize water service, it should be with the goal of increasing the affordability of water to meet basic human needs, such as is done with the California Water Service's Rate Support Fund which provides targeted assistance to the customers of water districts or water systems where the affordability of water is a real concern.

F. Differences between the provision of water and electricity and telecommunications services

Water is more akin to land than it is to electricity or telephone service in that water has a geographically limited supply and is locally based. California ratepayers are not entitled to live or work in an area with scarce water resources and expect to pay the same rate for water as ratepayers in a place where water is abundant. Water is a natural resource. While it is true that all utilities have distribution costs, it is difficult to import additional water to an area -- both from an engineering and water rights perspective. Unlike electricity and telecommunications systems, many small water systems are stand-alone systems that depend on local surface and groundwater supplies. Providing energy and telephone service to remote areas (while more costly than providing such service in urbanized areas) is generally not subject to limitations on the availability of resources. However, providing water to remote areas that have limited resources can require costly local infrastructure to produce and treat the water and can be environmentally damaging.[15]

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[15] See *e.g.*, Division of Ratepayer Advocates, Opening Brief, A.04-08-012 (stating, "[t]elephone and electricity infrastructures are generally interconnected through transmission and distribution systems. [By

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Moreover, interconnection of telecommunications and energy systems allows for easy movement of voice/data traffic or electricity among customers who are all interconnected. However, this is not possible in the water industry because water districts in the same region are not necessarily interconnected to each other or connected to outside sources of supply, such as the State Water Project or the Central Valley Water Project.[16] The interconnected nature of telecommunications and energy systems achieves real economies of scale and cost efficiencies that are not possible in the distribution of water.

In addition, providing water in arid areas can create wastewater disposal challenges from nitrates that can contaminate the groundwater. If water rates do not reflect the true cost of service, they could encourage inefficient and unsustainable uses of water in high-cost areas, *e.g.*, promoting housing developments in the desert.[17]

DRA notes that rate consolidation without real efficiencies and cost savings or an untargeted Water High-Cost Fund (WHCF) would break the link between cost of service and rates, and could provide water utilities with incentives to overinvest in individual water systems, a disincentive to control costs, a competitive advantage in acquisitions[18] and raise serious equity issues for customers. DRA recommends that the Commission

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contrast, individual water districts in the same region are not necessarily] interconnected to each other [or] connected to outside sources of supply, such as the State Water Project or the Central Valley Water Project. Also, unlike water infrastructure facilities, telecommunication wires generally do not have major environmental impacts. Electricity, unlike water, can be moved across the state almost instantaneously. Water is a much more localized commodity and is far less easily transported or shared.”).

[16] *Id*.

[17] The Division of Ratepayer Advocates (DRA) recognizes that in some instances there is negligible, if any, opportunity to further build out the urban areas of the districts served by the Class A water utilities. Thus, DRA is aware of the limited opportunities for growth in specific districts served by particular Class A water utilities, *e.g.*, the Monterey districts served by the California American Water Company.

[18] EPA/NARUC Report, *supra* note 10, at 5 (noting, “[s]econdary disadvantages are that—absent other incentives or safeguards—single-tariff pricing can provide some water utilities with incentives to overinvest in individual systems, disincentives for cost control, and a competitive advantage in the course of acquisitions.”).

consider the impacts of any water rate consolidation or High-Cost fund proposal on the long-term sustainability of California water supplies for existing customers (with an allowance for growth), on local land use, as well as effects of this proposal on both the local and regional environment. DRA recommends one or more workshops to further explore refinements to the 1992 policy guidelines jointly developed by DRA and the Class A water utilities to be considered in district rate consolidations (1992 Guidelines)[19] and look into whether and how to implement a water affordability rate subsidy fund, or RSF.

IV. DRA RESPONSES TO QUESTIONS IN THE OIR

The OIR orders the named respondents to answer the following questions:

A. Question 1

1. Identify current mechanisms utilized to subsidize rates and prevent rate shock, such as low income rates and rate support funds.

The following are known mechanisms used to subsidize rates and prevent rate shock. Notably, some of these mechanisms are not currently used in California.

- **Low Income Ratepayer Assistance (LIRA) Program.** All Class A utilities have some sort of Low Income Ratepayer Assistance (LIRA) program that provides a subsidy to customers who meet certain qualifications. The subsidy is provided through a surcharge from all non-LIRA-qualifying customers.[20]
- **Rate Increase Phase-in (CAPS).** The Commission has a standardized procedure in place, called CAPS, to defer a portion of the general rate increases of 50% for large water utilities, and 100% for smaller water companies. Revenues increases in excess of 50%

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[19] 1992 Guidelines for Combining of Water Utility Districts for Ratemaking and Public Utilities Commission Reporting Purposes, August 20, 1992, by the Division of Ratepayer Advocates (DRA) and representatives of the Class A water utilities (referred to below as "1992 Guidelines"), attached as Appendix A.

[20] *See* Appendix B, which contains information on LIRA programs provided by the Class A water utilities. Notably, the information has been aggregated and reformatted by DRA.

(or 100% for small systems) are tracked in a balancing account and earn interest at the utilities' authorized rate of return. The following year these differed revenues are added to any step increase for another rate increase also limited to 50% or 100%. This may be repeated one additional year if needed. Rates may temporarily rise above adopted levels while deferred revenues are recovered, but once all deferred revenues have been recovered, rates drop back to authorized levels.[21]

- **Public Interest Grants and Loans:** SRF and Prop 50 Funding. Infrastructure investments can be funded through low interest loans by public financing, instead of the higher interest loans by the utilities, resulting in significant savings to ratepayers. The Commission has instituted rules to protect the public interest integrity of these publicly funded grants and loans.[22]
- **Payment Plans**. Many utilities offer balanced payment plans, and help for those in arrears, etc.
- **Tiered Rates with Low First Tier**. Tiered or "blocked" rate structures increase the cost of water based on increasing levels of consumption. The first tier rate establishes an initial service tier price based on the minimum amount of water needed to fulfill the indoor water needs of the consumer. Anything above the base rate would be considered additional usage and consumers pay progressively higher rates.
- **Budget Based Water Rates**. Valencia Water Company and several public agencies use Budget Based Water Rates that are set up similar to a tiered rate system but function differently. Generally, Budget Based Water Rates have multiple tiers that are customized for each customer and their outdoor irrigation needs. Typically, the first two

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[21] CAPS Standard Procedure, Memo to Professional Staff from W.R. Ahern, Director, CPUC Utilities Division, February 22, 1983, attached as Appendix C.

[22] D.06-03-015, p. 1 (stating, "[t]his decision adopts rules that shall govern the accounting and ratemaking treatment for all future state grant funds received by all classes of regulated water utilities. With the passage of Proposition 50 - The Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 (Proposition 50), for the first time California's investor-owned water utilities applied for state grant funds. Receipt of these funds by Commission-regulated water utilities will allow the utilities and their customers to benefit by providing cost-free funds for needed investments in water supply, treatment, and security. Under Proposition 50, regulated water utilities can apply to the California Department of Health Services (DHS) and the California Department of Water Resources (DWR) for approximately $430 million in grants.").

tiers are based on an "efficient use" water allocation for indoor use (Tier 1) and outdoor use (Tier 2). Each progressive tier after Tier 2 is aptly named "Excess" to "Wasteful" and customers pay progressively higher rates. The revenues generated from Tiers 3 and above may be considered excess revenues and public agencies have used them to pay all conservation costs for the district. In addition, some public agencies have designed their budget based rates so that all the fixed costs are recovered in Tiers 1 and 2, thereby minimizing under collections when there is a reduction in consumption due to conservation, economic downturns or weather.

- **Consolidated Rates**. Consolidated rates, or single-tariff pricing, unify the rate structure of multiple districts under a single utility. For example, Golden State Water Company has consolidated rates in its Regions II and III.[23]

- **Rate Support Fund**. California Water Service Company has a Rate Support Fund program where low income districts that meet certain parameters are subsidized up to $24 on their monthly bills[24]. This program is funded by surcharges in multiple other districts. (*See* DRA response to Question 5 for a more detailed discussion of Rate Support Funds).

- **Sinking Fund**. A Sinking Fund is a type of savings account where funds are collected in advance via a surcharge and set aside for emergencies or infrastructure improvements. This has not been used much by investor-owned utilities, but a similar mechanism was proposed by California American Water Company to offset the high cost of its proposed Coastal Water Project.[25]

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[23] D.00-06-675 (In approving A.98-09-040, the Commission reiterated that it was not establishing a generic policy and that in the future it would continue to consider proposals for cost averaging on a case-by-case basis, with the burden on proponents of such plans to show substantial benefits in the public interest. Notably, the decision also directed Southern California Water Company (SCWC) to continue to calculate revenue requirements on a stand-alone district basis for its Region III, and, provide an analysis of the results annually, with copies of the district annual reports, with such results subject to analysis and recommendations by the Commission's Water Division and by communities served within the region.).

[24] CPUC tariff sheet number 8595-W, California Water Service Company, filed January 27, 2011.

[25] In A.04-09-019, California American Water Company proposed a "Special Request 2 Surcharge" to be collected in advance from customers to build up a fund for the purpose of partially financing the Coastal Water Project prior to the facility being deemed used and useful, and placed into service. The funds collected through this surcharge were intended to offset the high cost of the project during construction to

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2. Are these current mechanisms adequate to address ratepayer needs in general?

Because of the variability in demographics and characteristics of each district, no single mechanism exists that can be universally applied to resolve an issue or fulfill the needs of all ratepayers. However, the selective and complimentary use of the above mechanisms can provide effective relief to ratepayers. In order to understand the needs of particular districts and ensure that mechanisms are appropriately tailored to provide targeted relief, it is necessary to review such proposals on a case-by-case basis in each utility's general rate case.[26]

3. Do these current mechanisms achieve an appropriate balance between utility investments, conservation and affordability of rates?

Utilities must address the supply, quality and affordability of service rates charged to customers, while also balancing investments, conservation and utility viability. DRA is concerned that balance is shifting away from affordably in recent rate cases. Customers have expressed their outrage over continuous requests for significant rate increases, especially in light of the recent economic recession.

Conservation mechanisms are a good tool for addressing the affordability of water while promoting efficiency. Tiered rates, for example, can be effective at meeting the needs of low income ratepayers while also serving as a vehicle for promoting conservation if appropriately applied. Theoretically, if the meter charge is low while tiered quantity rates get progressively higher based on usage, it promotes conservation

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reduce rate shock when the entire project was placed into ratebase. Funds collected via this surcharge would have been considered "customer contribution". *See* D.11-09-039, p.5, fn. 4 (noting that although the Commission authorized the collection of funds through the "Special Request 2 Surcharge," according to the parties involved in the operative settlement agreement, the proposed ratemaking treatment in the settlement agreement obviated the need for the collection of the surcharge).

[26] See *infra* Section IV(G) (wherein DRA analyzes whether, and to what extent, the statutory requirements of Public Utilities Code sections 701.10 and 739.8 impact the establishment of a WHCF or the implementation of single tariff pricing in response to Question 7).

and provides all ratepayers with the ability to keep their rates affordable by reducing consumption. In addition, the cost of supplying excessive amounts of water would be applied appropriately to those responsible for the high costs associated with the extra demand.

Mechanisms designed to offset investments can also be challenging. Sinking Funds used to subsidize investments and reduce rate shock that may result from future emergencies and infrastructure improvements appear analogous to a good insurance plan that balances the needs of utilities and ratepayers. However, Sinking Funds, as well as High-Cost funds, which are intended to prevent rate shock, may end up also transferring the burden of the high cost of water from one ratepayer to another if the effects of these programs on all ratepayers are not considered. For example, an improperly designed program may cause low income communities to subsidize more affluent communities located in areas that are costly to support.

B. Question 2 - Should the Commission modify the existing 1992 consolidation guidelines, as described in D.05-09-004? If so, what specific modifications are warranted and what are the justifications for those modifications?

As explained in decision (D.) 05-09-004, in 1992 the Commission's Division of Ratepayer Advocates and the Class A water utilities "jointly developed a set of policy guidelines to be considered in district rate consolidations" (1992 Guidelines).[27] The 1992 Guidelines establish four characteristics or criteria to be considered in evaluating proposed consolidations: proximity, rate comparability, water supply and operation. The 1992 Guidelines describe each of these criteria as follows:

> "Proximity: The districts must be within close proximity to each other. It would not be a requirement that the districts be contiguous as it is recognized that present rate-making districts consist of separate systems

[27] D.05-09-004, p.7. *See* 1992 Guidelines, *supra* note 19, at 1-2.

which are not connected. It was suggested that districts within 10 miles of each other would meet the location criteria.

Rate Comparability: Present and projected future rates should be relatively close with rates of one district no more than 25% greater than rates in the other district or districts. To lessen the rate impact of combining districts it may be necessary to phase in the new rates over several years.

Water Supply: Sources of supply should be similar. If one district is virtually dependent upon purchased water, while another district has its own source of supply, future costs could change by a greater percent for one district versus the other. This could result in significantly different rates in the future even if present rates were quite similar.

Operation: The districts should be operated in a similar manner. For example, if a single district manager presently operates two or more districts and the billing system is common to the same districts, such an operation would support the combination of the districts."

Significantly, the 1992 Guidelines also state that "[i]t was agreed that no districts would be combined for the express purpose of having one district subsidize another."[28]

As stated in D.00-06-075, the 1992 Guidelines were intended to set criteria for single tariff pricing that, when satisfied, establishes prima facie reasonableness of the proposed consolidation.[29] Thus, as the Commission explained in D.05-09-004, "[w]hen the [1992 Guidelines] are not met there is no *prima facie* reasonableness and thus the burden of showing that the advantage of consolidation outweigh[s] the disadvantages falls upon the applicant. . . . [the] Commission may approve a consolidation proposal even though it does not exactly meet the criteria set forth in the [1992] Guidelines."[30] In

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[28] 1992 Guidelines, *supra* note 19, at 2.

[29] D.00-06-075, p. 27. See *id*. (noting that "[a] number of rate consolidations have been approved pursuant to the [1992 Guidelines] without opposition by the Commission's advocacy staff."). Similarly, a number of rate consolidations have been rejected by the Commission. See *e.g*., D.08-05-018, p. 40 (wherein the Commission explained, "we do not adopt the Cal Am consolidation proposal as we cannot justify Sacramento district customers funding a rate decrease for Larkfield residents.").

[30] D.05-09-004, p. 9 (*quoting* Office of Ratepayer Advocates (ORA) Opening Brief in A.04-08-012, at page 12, and California American Water's application, A.04-08-012, at page 12, respectively).

D.00-06-075, the Commission further explained that "[t]he [1992 Guidelines] implicitly permit proposals for broader rate consolidations, with the understanding that such proposals are likely to be protested by the advocacy staff in order that a full record can be developed for Commission consideration."[31]

The purpose of the 1992 Guidelines is to streamline DRA review of proposals for district consolidation. The 1992 Guidelines do not limit the Commission's ability to review any such proposal on a case-by-case basis. Significantly, as noted, the Commission has authority to approve consolidations that do not satisfy one or more of the four criteria set forth in the 1992 Guidelines.[32] Thus, given the purpose of the 1992 Guidelines and the fact that the Commission retains discretion to consider all proposals for district consolidation on a case-by-case basis, it is unnecessary to modify the 1992 Guidelines at this time.

However, DRA recognizes the particular thresholds in the 1992 Guidelines, *e.g.*, the 10 mile threshold suggested in the Proximity criterion and the 25 percent threshold stated in the Rate Comparability criterion, may not be hard and fast indicators of the propriety of district consolidation in some instances. Moreover, additional criteria may also be relevant to the determination of whether district consolidation is warranted, *e.g.*, average water use. Thus, DRA would welcome the opportunity to discuss the possibility

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[31] D.00-06-075, p. 27. *Cf.* D.08-05-018, at p.33 (apparently limiting the Commission's discretion to approve consolidations that do not satisfy the Proximity criterion in the 1992 Guidelines, stating "consolidation of non-adjacent districts can only be consolidated in exceptional cases.").

[32] See *e.g.*, D.00-06-075 (wherein the Commission approved rate consolidation for eight Southern California Water Company (now referred to as Golden State Water Company) districts that were (1) not interconnected, (2) had varied water sources, and (3) ranged from 5 to 163 miles apart). Notably, DRA supports the position of Commissioner Richard A. Bilas, who dissented from the Commission's decision in D.00-06-075, stating, "The primary arguments in support of this proposal are rate stability and affordability. But in this case, affordability for a few is provided at a significant cost to many. The average pricing method requires that all customers in [Southern California Water Company's] larger, lower-cost districts subsidize all customers in the smaller, high-cost districts. Indeed, poorer customers in lower cost districts will subsidize wealthier customers in high cost districts. I find this economically inefficient and highly discriminatory."). The full text of D.00-06-075 is available online at http://docs.cpuc.ca.gov/WORD_PDF/FINAL_DECISION/1062.DOC.

of refining the four existing criteria in the 1992 Guidelines and/or the potential inclusion of additional criteria in workshops that could be conducted as part of this rulemaking.

C. Question 3 - To the extent a new district consolidation mechanism is necessary, identify and discuss significant characteristics of water districts that should be included in an analysis of whether consolidation is appropriate. Examples of significant characteristics include: infrastructure, geography, topology, hydrology, climate, water quality, nature of water supply, rate differences and average water usage.

Each district should be considered unique based on its characteristics and demographics, and the Commission should continue to review any proposed district consolidation on a case-by-case basis. As explained above, the 1992 Guidelines sufficiently address the most significant characteristics or criteria that should be considered when determining whether a proposed district consolidation will result in efficiencies and yield actual cost savings. Further, many of the significant characteristics of water districts noted in the question are, in fact, already subsumed by the four criteria identified in the 1992 Guidelines. More specifically, consideration of infrastructure, geography, hydrology, and nature of water supply, are subsumed by the Water Supply criterion in the 1992 Guidelines. Similarly, consideration of rate differences is subsumed under the Rate Comparability criterion in the 1992 Guidelines.

DRA has, however, identified a few additional characteristics of water districts that should possibly be considered by the Commission when deciding whether to approve a consolidation proposal, and which would be appropriately discussed during workshops conducted as part of this rulemaking. These additional characteristics are as follows:

1. Average Water Use

Subsidization should not be done in a way that promotes inefficient water use. Districts that use water inefficiently should not be rewarded with a reduced rate through subsidization from a district with similar characteristics but lower water usage. Customers with higher or less efficient water use have the flexibility to manage their bills by using water more inefficiently.

2. Synergies

Consolidation should benefit all ratepayers in the districts being consolidated. If District A is investing in infrastructure and consolidating with District B, consolidation should only be considered when rates remain affordable for all and District B is receiving an equivalent benefit from the consolidation. This can be in the form of direct benefits from District A's improvements, future investments in infrastructure improvements for District B, or a reduction in rates. It can also include unrelated benefits for things like a supplemented water supply or a reduction in administrative costs. Pertinent questions include: Does the proposed consolidation lower costs through economies of scale? Are there any cost savings, or would the proposed consolidation simply allocate costs differently?

3. Average Income Level

A low-income district should not subsidize a high-income district. It would make sense to subsidize low-income, low-use customers whose rates are high and whose water is unaffordable, as opposed to subsidizing high-income customers whose rates are high because the cost of service is high, such as in isolated resort areas. For example, Cal Am attempted to consolidate Larkfield, with a higher average income and high-costs, with relatively lower-income Sacramento.[33] Had the consolidation been approved, the lower income district's rates would have increased to subsidize the higher income district.[34]

D. Question 4 - What advantages and disadvantages, if any, would result from implementing a "High-Cost" fund?

In the 2005 Water Action Plan (WAP), the Commission set forth six objectives including setting rates that balance investment, conservation, and affordability. The WAP further elaborated the desire to develop policies to subsidize high-cost areas, either

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[33] D.08-05-018, p. 40 (stating, "we do not adopt the Cal Am consolidation proposal as we cannot justify Sacramento district customers funding a rate decrease for Larkfield residents.").

[34] *Id.*

through some variation of a High-Cost fund or through consolidation of districts or rates. It noted that, "the CPUC has used a similar approach for telecommunication ratepayers, via the so-called High-Cost Fund-A for small local telecommunication companies and the High-Cost Fund-B for the larger local telephone providers."[35]

In order to address the advantages and disadvantages that would result from implementing a High-Cost fund for water utilities, DRA has provided some background and comments on High-Cost funds in general, and how the Commission established telecommunications High-Cost funds work.

1. Background on Telecommunication High-Cost Funds

Telecommunication High-Cost funds were established in the United States to support universal service goals to ensure that consumers in all areas have access to and pay rates for telecommunication services that are reasonably comparable to those in urban areas. Prior to the breakup of AT&T and the introduction of competition in the long distance market, the independent telephone companies (ITCs) relied on access charge revenues from long-distance carriers to help finance their local operations.[36] After the breakup of AT&T in 1984, the Commission established the original California High-Cost Fund (CHCF). Subsequently, with the introduction of competition in the local exchange market and the deregulation of competitive services that had previously subsidized the non-competitive services like basic phone service, the Commission was

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[35] California Public Utilities Commission, Water Action Plan, December 15, 2005, p. 21, *available at* ftp://ftp.cpuc.ca.gov/PUC/hottopics/3water/water_action_plan_final_12_27_05.pdf.

[36] The Office of Ratepayer Advocates' Review of the California High Cost Fund B.: A $500 Million Subsidy Program for Telephone Companies, California Public Utilities Commission Office of Ratepayer Advocates, March 22, 2004, p. 3, *available at* ftp://ftp.cpuc.ca.gov/resources/telco/ora+chcf-b+report+3+22+04+public+version.pdf (referred to below as "ORA Report") (stating, "[l]ong-distance carriers pay access charges to compensate local exchange companies for connecting calls to/from inner exchange carrier networks from/to the local exchange carrier's customers.").

faced with the dilemma of how to ensure universal availability of basic telephone service.[37]

In September 1996, the Legislature amended Public Utilities Code Section 739.3 to develop a competitively neutral, broad-based program to help ensure that telephone service was widely available and affordable under local competition. The purpose of the program was to promote the goals of universal telephone service and reduce any disparity in rates charged by telephone companies.

In October 1996, with D.96-10-066, the Commission established the California High-Cost Fund-B (CHCF-B) to allow new market entrants access to universal service funds for providing residential local exchange service to areas where the cost of providing telephone service exceeded the rates charged to customers.[38] As stated in D.96-10-066, the objectives of the CHCF-B program are to promote the goals of universal telephone service and reduce rate disparity, while encouraging competition.[39] To distinguish the new CHCF-B from the existing CHCF program, which provided support to small, cost of service ITCs, the Commission renamed the existing CHCF program the "CHCF-A" and called the new program the "CHCF-B".

"The new program required the Commission to first 'extract' implicit subsidies supporting basic local exchange service, and to then replace those subsidies with funds provided by the CHCF-B, and make them available to all eligible carriers."[40] This was done to prevent any windfalls to the carriers receiving the new subsidy.

The CHCF-B subsidy was only available to service providers designated as "carriers of last resort" (COLRs) operating in the territories of price cap regulated incumbent local exchange carriers (ILECs) under the New Regulatory Framework

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[37] *Id*. at 4.

[38] D.95-07-050, p. 34.

[39] D.96-10-066, p. 626.

[40] ORA Report, *supra* note 36, at 5.

(NRF).[41] COLRs could claim a subsidy for each residential "primary" line served in a designated high-cost area.

COLRs did not need to provide current cost support to confirm the carrier incurs high costs or to otherwise justify the claimed subsidy.[42] Instead the Commission relied on a complex model, the Cost Proxy Model (CPM). The Commission decided that Census Block Groups (CBGs) with an average per line cost greater than the statewide average cost would be designated "high cost".[43] In a given high-cost area, a COLR's subsidy was computed by taking the difference between the proxy cost for that CBG and the carrier's tariff rate. In addition, any other revenues the carrier receives for that line are subtracted from its CHCF-B claim.

The program funding comes from a CHCF-B surcharge imposed on all telecommunications customers, except low-income customers on the Lifeline program. In the earlier years of the program, the surcharge fluctuated from 1.4% to 3.8% of a customer bill.[44] In 1997, CHCF-B was to provide $352 million per year in carrier subsidies. By 2002 the budgeted subsidy had grown to nearly $500 million.[45]

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[41] *Id*. at 8, fn. 22 (explaining that the NRF carriers, all COLRs, "are Pacific, Verizon, Citizens Telephone Company and Roseville Telephone Company.").

[42] *Id*. at 8.

[43] In 1996, D.96-10-066 adopted and adjusted CPM. Each CBG was given a proxy cost based on 1994 costs. The decision then derived statewide average cost of $20.30 and set that as the threshold for designating a CBG as a high-cost area. *See also* ORA Report, *supra* note 36, at 10.

[44] California Public Utilities Commission Resolution T-17311, adopted March 24, 2011, p. 3, available online at http://docs.cpuc.ca.gov/word_pdf/FINAL_RESOLUTION/132760.pdf (referred to below as "Resolution T-17311") (explaining that the Commission now monitors and adjusts the CHCF-B surcharge: "The Commission has assigned its Communication Division (CD) to monitor the CHCF-B program fund balances to ensure that sufficient funds exist to pay CHCF-B claims and other program expenditures. Accordingly, CD periodically reviews CHCF-B program revenues and expenses. Since carrier claims are the primary program expense, CD annually seeks the CHCF-B carriers' forecasts of their estimated claims. These forecasts are then reviewed and compared with actual claims data. To assess the appropriateness of the surcharge level, CD considers the claims data as well as the program's fund balance, estimates of incoming revenues from the customer surcharge, and estimates of other expected expenditures. The total of the estimated claims and administrative expenses plus a contingency amount is used to estimate the budget.").

[45] ORA Report, *supra* note 36, at 12.

In June 2006, the Commission issued a rule making, R.06-06-028, to review the operation of the CHCF-B program to determine if the goals of the program could be continued while reducing costs. In D. 07-09-020, the Commission adopted major reforms to the CHCF-B program including reducing the size of the CHCF-B, and better targeting subsidies to cover only those high-cost areas where funding is necessary to meet universal service goals.[46] In 2009, the Commission opened a successor rule making (R.09-06-019) to consider the development of a reverse auction process and ways of automating and streamlining the processing of CHCF-B claims.

The CHCF-A program is run differently. In the CHCF-A program, carriers' funding requirements are determined through General Rate Cases (GRCs). If carriers cannot meet their revenue requirement with tariffed rates priced at up to 150% of the rates of comparable services in urban areas, they are granted the CHCF-A subsidy to cover the shortfall. The CHCF-A funding level for each carrier is the difference between the revenue requirement and the carrier's actual revenue. The CHCF-A support is then distributed to carriers directly on a monthly basis.[47] The CHCF-A is funded by an all-end-user surcharge, assessed as a percentage of all customers' intrastate service charges (other than LifeLine services).[48]

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[46] Resolution T-17311, *supra* note 44, at 2, describing the reforms adopted by the Commission to the CHCF-B program as follows:

- Reduced the CHCF-B surcharge from 1.3% to 0.5% effective January 1, 2008.
- Increased the threshold benchmark at which the COLRs are subsidized from the CHCF-B from $20.30 to $36.00 through series of steps beginning January 1, 2008 and ending July 1, 2009.
- Changed the method of calculation of the subsidy payment from the difference between cost and revenue to the difference between cost and the threshold level of $36.00 effective July 1, 2009.
- Set forth a schedule of reform measures to be considered in Phase II of the rulemaking proceeding including: (1) a reverse auction mechanism to determine future subsidy levels and (2) establishing a new fund to subsidize broadband deployment in unserved and underserved areas of California.

[47] R.11-11-007, page 9.

[48] *Id.*

In November 2011, the Commission opened a rulemaking, R.11-11-007, to review the CHCF-A.[49] As stated in the Order Instituting Rulemaking:

> "This OIR was issued pursuant to the Commission's Decision (D.) 10-02-016. A detailed review of the program is warranted in response to market, regulatory, and technological changes since the California High-Cost Fund program was first established in 1987. In this OIR, we seek comment on how the program can more efficiently and effectively meet its stated goals. To the extent deficiencies are identified, we solicit constructive proposals on whether the program should continue and if so, how should it be modified."[50]

As explained above, it is apparent that High-Cost fund programs are inherently complex to design and implement; if not done appropriately, they may not achieve program goals.

Furthermore, as noted, in the context of telecommunications, the establishment of High-Cost funds was intended to support universal service goals after the breakup of AT&T and the advent of local competition, which removed the internal cross subsidies that kept basic phone rates low. As investor owned water utilities continue to exist as monopolies in their respective service territories, there is no comparable justification for the establishment of High-Cost funds to subsidize the cost of water service. In addition, establishing such a fund that would cross Class A Water company boundaries would be particularly complex and raise numerous thorny issues.

A more targeted and tailored water affordability subsidy program would work better than subsidizing all so-called high-cost areas such as was done in the telecommunication sector. A program such as the Rate Support Fund (RSF) implemented by California Water Service (CWS) as a result of the settlement between

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[49] Order Instituting Rulemaking into the Review of the California High Cost Fund-A Program, California Public Utilities Commission, R.11-11-007, November 18, 2011, *available at* http://docs.cpuc.ca.gov/word_pdf/FINAL_DECISION/153584.pdf.

[50] *Id*. at 1.

DRA and CWS in 2006,[51] represents a more appropriate method of providing targeted assistance to areas where the affordability of water is a real issue. (See further discussion on next page.) Notably, in that example the subsidy is provided to the customer, and not the utility.

Against this backdrop, and considering the many differences between the provision of telecommunications services and that of water service, DRA cautions the Commission against implementing a similar High-Cost fund for water utilities based on the telecommunications model.

2. How could such a "High-Cost" fund operate?

It's not clear how a Water High-Cost Fund (WHCF) would operate. Many complex issues would have to be resolved to establish such a fund, given the fact that, unlike the integrated network of the telecommunications system, water resources are more localized in nature. For example, the National Regulatory Research Institute paper titled "State high-cost funds: purposes, design, and evaluation" issued on January 19, 2010, cautions:

> "States considering whether to establish a high cost fund should consider the following questions:
>
> - Is a fund needed?
> - Is there legal authority for a fund?
> - What are the fund's goals?
> - What services, providers, and facilities should be supported?
> - What distribution mechanism is best?

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[51] *See* Joint Motion of California Water Service Company (U-60-W) and the Division of Ratepayer Advocates to Approve Stipulation Concerning Rate Base Equalization Account (RBEA) Settlement and Rate Base Equalization Account (RBEA) Settlement in A.05-08-006, both attached as Appendix D, (collectively referred to below as the "RSF Settlement Agreement"). *See also* D.06-08-011, at 14, approving the RSF Settlement Agreement, and D.10-12-017, at 47, revisiting and once again approving the RSF Settlement Agreement.

- Are controls needed over fund size?
- How will funds be collected?
- Who will administer the fund?
- How will the fund be evaluated and made accountable for results?"[52]

If a WHCF were to be funded by an end-user surcharge on all Class A investor-owned water companies, it could easily become unreasonably complex and raise numerous equity issues in determining how to allocate funds collected across utility companies.

DRA instead recommends further consideration of an intra-company mechanism to subsidize the high cost of water service in low income, low consumption, and high-cost areas such as instituted by CWS with its Rate Support Fund.[53]

In 2006, the Commission issued D.06-11-008 that adopted a settlement agreement between California Water Service, DRA and various interveners to set up a subsidy mechanism by the name of the CWS Rate Support Fund (RSF) to provide general rate assistance benefit to all customers in eligible CWS districts.[54] The eligible districts included Kern River, Redwood Valley-Lucerne, Redwood Valley-Co. Springs in Redwood Valley-Unified as well as 123 customers in the impoverished and low water usage area of Fremont Valley in the Antelope Valley District. These districts were selected taking into account the affordability of rates based on district income levels, usage levels, ratebase per customer, availability of public loan funds and average bills in each district as well as any extraordinary water quality problems in those districts.[55]

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[52] State High Cost Funds: Purposes, Design, and Evaluation, National Regulatory Research Institute, Appendix A – Summary of Steps to Establish a High Cost Fund, *available at* http://www.nrri.org/pubs/telecommunications/NRRI_state_high_cost_funds_jan10-04.pdf.

[53] See *supra* note 51.

[54] *Id*.

[55] *Id*.

The RSF was initially funded via a volumetric surcharge of approximately 1 penny on every unit of water sold by CWS in all 24 of the districts. Parties agreed that any and all customer support would be listed on the customer bill as the "Rate Support Fund Assistance" and rates shown on customer bills for districts receiving RSF assistance would reflect tariff rates with the RSF benefits separately identified as offsets to the tariff rates.

The Settlement further provided that the program would be revisited in the next CWS general rate case.[56] RSF subsidies and surcharges were to be booked into a single balancing account with subsidies recorded for each district. CWS agreed to file an advice letter to determine whether to adjust the surcharge if the balancing account is over or under collected by 10% of the total annual revenues for the districts receiving support.

DRA recommends that this type of targeted subsidy mechanism be used in lieu of a telecommunications style WHCF.

E. Question 5 - What requirements and conditions, if any, should be included in any new district consolidation mechanism or "High-Cost" fund?

As explained in response to the previous question, DRA does not support the establishment of a water High-Cost fund unless it is targeted to increase affordability for those most in need. DRA addresses this question by expanding on ideas for consideration in the design of any water affordability subsidy fund, such as the CWS Rate Support Fund, to increase water affordability, and refers the Commission to DRA's response to Question 3 for a discussion of potential additional criteria to be added to the 1992 Guidelines.

DRA recommends that the Commission hold a workshop to consider a targeted water affordability subsidy fund that could provide rate assistance to an entire district. DRA recommends the Commission consider the following questions in the workshop:

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[56] *See* D.10-12-017, at 47 (revisiting and once again approving the RSF Settlement Agreement).

1) Under what circumstances should a departure from cost-based ratemaking be approved?
2) What should district eligibility criteria be?
    a. Income threshold - DRA suggests that at least 50% of a district's customers should be at or below 200% of federal poverty guidelines-the CPUC standard for low-income energy assistance programs.
    b. Usage threshold - DRA suggests average residential water usage of 10 Ccfs or less.
    c. Extraordinary water quality challenges - DRA suggests some flexibility in the above to guidelines to meet unprecedented high expenses due to sudden changes in water quality requirements, such as previous changes in the arsenic standard.
3) What should the criteria be for the size of any subsidy?
4) What is the expected benefit per customer? (*e.g.*, the total subsidy divided by the number of customers in the district.)
5) How should the benefit be allocated? Should it be an offset to the meter charge or the quantity rates? DRA recommends any subsidy should be an explicit credit on the customer bill for transparency as to the true cost of service in any district.
6) What is the cost burden to subsidizing ratepayers? Who will pay?
7) Should there be a cap on the size of the subsidization fund? If so, how much?
8) What type of surcharge should be used to allocate the cost burden-a fix surcharge per customer, a volumetric surcharge per unit of water consumed, or percentage of the bill? DRA recommends an equal cents per Ccf volumetric surcharge.
9) How should the subsidy be reflected on customer bills? DRA recommends it be a separate and explicit charge on the subsidizing customer bills.

DRA recommends that before approving any water affordability subsidy program, the Commission should ensure that there is a compelling need for rate relief. Rate shock, which is a result of sharp rate changes and not necessarily unaffordable rate levels, is not a sufficient justification to ask other ratepayers to subsidize the cost of water service in disparate districts. The Commission has the CAPS procedure in place to defer a portion

of the general rate increases in excess of 50% for large water utilities, and 100% for smaller water companies.[57]

DRA recommends that any subsidies granted be short term and not on-going. Even if the cost-of-service is subsidized in a given district, it is imperative that each district maintain separate records, so as not to mask the true cost of service in the district and/or limit the ability of the Commission and DRA to evaluate the efficiency and costs of the water district operations.

In addition, as noted elsewhere in these comments, DRA is concerned that any water affordability subsidy program not result in an inappropriate level of subsidy or undue price discrimination where high-cost customers are subsidized at the expense of low-cost customers. The cost of providing water is different in different parts of California and a differential in operating costs or capital investment per customer is to be expected. Many of the capital-intensive aspects of water systems have a direct correlation to the environment. If water rates do not reflect the true cost of service, they could encourage inefficient and unsustainable uses of water in high cost areas.

F. Question 6

1. What impacts would increased consolidation of water utility districts or the establishment of a "High-Cost" fund have on: (A) land development in the districts and (B) ongoing water and energy conservation efforts, including those mandated by Federal and State laws such as the Water Conservation Act of 2009?

If consolidation results in artificially low water rates, development may be encouraged where water is scarce or comes at a high cost to supply. This would

[57] See *supra* note 21.

contradict the state conservation and land use planning/sustainability goals of SB 732[58], AB 32[59], SB 375[60], and SBX 7-7[61].

Water scarce areas tend to have higher rates than areas with sufficient water sources. If consolidated, one district will ultimately bear a portion of the burden of cost for supplying water to the other district while the one being subsidized will have artificially low rates relative to the cost of service received. Since usage is generally tied to price, tying together districts with different supply characteristics could send the wrong message to customers and inhibit conservation where it is most needed.

In addition, Integrated Regional Water Management Plans (IRWMP) depend on local/regional entities having common characteristics such as water scarcity, protecting the same watersheds, etc. If a district's water price is no longer tied to the actual costs of providing water, it will frustrate the ability to participate in IRWMPs.

2. Is it possible to effectively mitigate these impacts?

It is unlikely that effective mitigation could be developed. Clear pricing signals incentivize conservation by allowing households to respond to increased water prices in the manner of their choice.[62] Allowing consolidation to subsidize ratepayers, regardless of income, in regions that are difficult and costly to support could encourage unsustainable growth and lead to higher prices for all ratepayers. DRA prefers other mechanisms to support the affordability of water service.

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[58] The Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act, SB 732, Steinberg, Statutes of 2008.

[59] California Global Warming Act, AB 32, Nunez, Statutes of 2006.

[60] Sustainable Communities Strategy, SB 375, Steinberg, Statutes of 2008.

[61] Water Conservation Act, SBX 7-7, Steinberg, Statutes of 2009.

[62] Managing Water Demand: Price vs. Non-Price Conservation Programs, Pioneer Institute, Sheila M. Omstead and Robert Stavins, No. 39, July 2007, p. 5, *available at* http://www.hks.harvard.edu/fs/rstavins/Monographs_&_Reports/Pioneer_Olmstead_Stavins_Water.pdf.

DRA notes that this rulemaking is addressing guidelines for the consolidation of water districts within a given company. DRA supports this goal when such consolidations achieve real economies of scale, efficiencies and actual cost savings.

G. Question 7 - What impact, if any, would Public Utilities Code Section 701.10 or other statutory requirements have on the ability of district water utilities to establish a "High-Cost" fund or to increase consolidation?

The establishment of High-Cost funds and/or district consolidation of water rates raise two possible points of tension with the statutory requirements of Public Utilities Code section 701.10.

1. Section 701.10(c)[63] – Appropriate Incentives for Conservation of Water Resources

As stated in Section 701.10, subdivision (c), "[t]he policy of the State of California is that rates and charges established by the Commission for water service provided by water corporations shall . . . [p]rovide *appropriate* incentives to water utilities and customers for conservation of water resources." (Emphasis added).

a) Appropriate Incentives for Conservation of Water Resources under Single-Tariff Pricing

One of the primary disadvantages of rate consolidation across multiple districts, or single-tariff pricing, is the distortion of price signals to customers.[64] By weakening price signals, and thus undermining efficient water production and consumption, single-tariff pricing "seems to be at odds with water conservation."[65]

However, research suggests that other rate design features, *e.g.*, the mix of fixed and variable charges, the number of rate blocks, rate-block differentials, and seasonal

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[63] All section references are to the California Public Utilities Code, unless otherwise indicated.

[64] EPA/NARUC Report, *supra* note 10, at 5.

[65] *Id.*

differentials, can promote the efficient use of water in conjunction with single-tariff pricing.[66]

Further, determining whether the adoption of single-tariff pricing across particular districts is in the public interest involves a tradeoff between competing policy objectives, including economic efficiency, rate and revenue stability, affordable service, compliance with environmental standards, and conservation.[67] For example, a fine-tuned price signal may result in considerably less rate and revenue stability.[68] Similarly, a rate schedule designed to promote conservation may not be affordable to customers.[69]

Moreover, the 2005 Water Action Plan includes the express objective to "[r]eview utility rate case revenue requirements from the perspective of long-term investment and conservation, as well as shorter-term rate impacts."[70] In D.08-05-018, the Commission stated that in light of this directive when determining whether to approve a proposed district rate consolidation, "the Commission cannot look at any **one** policy objective in isolation of others."[71]

Accordingly, the question of whether the implementation of single-tariff pricing should be permitted in particular districts involves the consideration of a number of factors. Adherence to the statutory mandate of section 701.10, subdivision (c) must be understood in this multi-faceted context. Thus, the determination of whether a particular rate schedule, including the implementation of single-tariff pricing across multiple districts, provides an "appropriate" incentive to promote water conservation is a fact-

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[66] *Id*. at 18.

[67] *Id*. at 6.

[68] *Id*. at 6.

[69] *Id*.

[70] Water Action Plan, California Public Utilities Commission, adopted December 15, 2005, p. 20, *available at* ftp://ftp.cpuc.ca.gov/PUC/hottopics/3water/water_action_plan_final_12_27_05.pdf.

[71] D.08-05-018, at p. 38.

specific inquiry that must be analyzed on a case-by-case basis, and which must take into consideration the "appropriate" balance between competing policy objectives.

b) Appropriate Incentives for Conservation of Water Resources under High-Cost Funds

As noted, the establishment of a telecommunications style High-Cost fund to reduce rates for water service would also send distorted price signals, thus potentially encouraging unsustainable development in particular areas. However, in contrast to district consolidation, which, in appropriate circumstances, can achieve various policy objectives and, overall, produce a net benefit for consolidated districts, High-Cost funds have not traditionally been used to reduce rates for water service. Further, as explained above, High-Cost funds are inherently complex to design and implement; if not done appropriately, they may not achieve program goals.

2. Section 701.10(f) – Rates and Charges Shall be Based on the Cost of Providing Water Service

Section 701.10, subdivision (f) provides, in pertinent part, that "[t]he policy of the State of California is that rates and charges established by the Commission for water service provided by water corporations shall . . . [b]e based on the cost of providing the water service."

a) Single-Tariff Pricing vs. Statutory Requirement that Rates and Charges be Based on the Cost of Providing Water Service

To the extent that the implementation of single-tariff pricing results in rates and/or charges to customers that do not accurately reflect the cost of providing water service in particular districts, such an application would be in tension with the policy stated in section 701.10, subdivision (f).

However, the Public Utilities Code also authorizes the Commission to implement programs that provide rate-relief to low-income rate payers. More specifically, section 739.8 states:

(a) Access to an adequate supply of healthful water is a basic necessity of human life, and shall be made available to all residents of California at an affordable cost.

(b) The Commission shall consider and may implement programs to provide rate relief for low-income ratepayers.

(c) The Commission shall consider and may implement programs to assist low-income ratepayers in order to provide appropriate incentives and capabilities to achieve water conservation goals.

(d) In establishing the feasibility of rate relief and conservation incentives for low-income ratepayers, the Commission may take into account variations in water needs caused by geography, climate and the ability of communities to support these programs.

Under the authority provided by section 739.8, the Commission has ordered investor-owned water utilities to implement Low Income Ratepayer Assistance (LIRA) programs. The utilities fund LIRA programs by either assessing a surcharge prospectively on non-participating customers, or recording all costs of the program in a balancing or memorandum account for later recovery from non-participating customers via a surcharge.[72] In either case, customers that receive assistance are exempt from paying for the cost of the LIRA.[73] Accordingly, surcharges paid by non-participating customers to fund a LIRA are not directly allocable to the provision of water service but are nevertheless authorized by section 739.8.

Therefore, to the extent that implementation of single-tariff pricing provides rate-relief to low-income rate payers, such an application would appear to be expressly authorized by section 739.8. Paradoxically, to the extent that implementation of single-

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[72] Wilson, Seaneen M., Assessment of Water Utility Low-Income Assistance Programs, California Public Utilities Commission, Division of Water and Audits, p.10, October 2007, *available at* http://www.cpuc.ca.gov/NR/rdonlyres/159B7FB3-D717-41C3-9BCE-27FFE7530AD5/0/dwa_lowincome_research_paper_112507.pdf. See *id*. at 4 (noting that the "Commission's Water Action Plan, adopted in December 2005, details the policy objectives that are to guide the future regulation of investor-owned water utilities [and that one] of the major objectives of the Water Action Plan is to develop and expand programs to assist regulated water utility low-income ratepayers.").

[73] *Id*. at 10.

tariff pricing results in subsidies from low-income customers in a low-cost area to higher-income customers in a high-cost area, such an application would not be authorized under section 739.8, and thus, would appear to be in unmitigated tension with the policy stated in section 701.10, subdivision (f), *i.e.*, that rates shall be based on the cost of providing water service.

b) High-Cost Funds vs. Statutory Requirement that Rates and Charges be Based on the Cost of Providing Water Service

Similarly, to the extent that the establishment of a High-Cost fund results in rates that do not accurately reflect the cost of providing water service in particular districts, it appears to be in tension with the policy stated in section 701.10, subdivision (f). However, as explained above, to the extent that such a High-Cost fund provides rate-relief to low-income customers, such a program would appear to be expressly authorized by section 739.8.

H. Question 8 - Identify any additional impacts that would result from increased consolidation of water utility districts or the establishment of a High-Cost fund.

With climate change, population growth, rising energy costs and an aging infrastructure, California's water will become increasingly scarce and less affordable. State policy goals have been established to tackle these issues with conservation and smart growth. Mechanisms can also be a helpful tool, but there must be established criteria that will keep us on track to meet our policy objectives while maintaining transparency and keeping water affordable for all.

V. CONCLUSION

DRA recommends the appropriate use of district consolidation or targeted water affordability subsidy funds as effective interventions to achieve various policy objectives, including economic efficiency, rate and revenue stability, affordable service, compliance with environmental standards, and conservation. In particular, subsidization programs

should be designed to promote efficient water use and should be targeted to benefit areas where the affordability of water service is a real concern.

DRA urges the Commission to retain the 1992 Guidelines as they provide a good starting point for the review and consideration of any utility district consolidation proposal. But should a proposal not meet the criteria set forth in the 1992 Guidelines, it may still be in the public interest, and thus, should be reviewed on a case-by-case basis.

DRA cautions against the establishment of any water High-Cost fund. Water and telecommunications services are extremely different, and the mere fact of water being higher cost, doesn't necessarily make it unaffordable. Any rate subsidies should be targeted to increasing affordability. DRA recommends the Commission convene a workshop to discuss guidelines for targeted water affordability subsidy funds, such as the CWS Rate Support Fund.

Respectfully submitted,

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