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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<br>(Filed November 10, 2011) |

# REPLY COMMENTS
# OF THE DIVISION OF RATEPAYER ADVOCATES

Pursuant to Rule 6.2 of the Rules of Practice and Procedure ("Rules") of the California Public Utilities Commission ("Commission"), and the instructions stated in Ordering Paragraph Number 5 of the Order Instituting Rulemaking issued on November 18, 2011 ("OIR") in the above-captioned proceeding ("Rulemaking"), the Division of Ratepayer Advocates ("DRA") respectfully submits the following Reply Comments.

## I. DRA'S REPLY COMMENTS TO QUESTION 2

The OIR poses the following question:

*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 DRA's Opening Comments in this Rulemaking, given that the policy guidelines jointly developed by DRA and the Class A water utilities to be considered in evaluating rate consolidation proposals ("1992 Guidelines") do not limit

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the Commission's ability to review proposals for district consolidation on a case-by-case basis, it is unnecessary to modify the 1992 Guidelines at this time.[1] Nonetheless, DRA recognizes that the 1992 Guidelines could be improved upon, and thus, welcomes the opportunity to discuss the possibility of refining the four existing criteria and/or the potential inclusion of additional criteria in workshops that could be conducted as part of this Rulemaking.

Although DRA supports workshops to discuss possible refinements or additions to the 1992 Guidelines, DRA strongly opposes suggestions by Golden State Water Company ("Golden State") that the Commission consider eliminating the 1992 Guidelines altogether, or eliminating three of the four current criteria, thus only retaining the "Operation" criterion.[2] The 1992 Guidelines' "Proximity," "Rate Comparability" and "Water Supply" criteria reflect critical considerations that should be taken into account by the Commission when reviewing any consolidation proposal.[3]

Further, DRA notes that California-America Water Company ("California American Water") has included a table in its Opening Comments in response to Question 2 in order "[t]o illustrate the breadth of discrepancies in customer billing," *i.e.*, by

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[1] Opening Comments of the Division of Ratepayer Advocates, R.11-11-008, March 1, 2012, at 15 (referred to below as "DRA's Opening Comments").

[2] Initial Comments of Golden State Water Company (U133W) With Responses to Questions and Scenarios in Order Instituting Rulemaking, March 1, 2012, at 9 (stating, "GSWC encourages the Commission to consider modifications to or elimination of [the 1992 Guidelines] as needed to meet the goals described in the OIR. . . . if it is the intent of the Commission to facilitate the consolidation of districts, it should be more flexible and not require that the companies meet all four of the current consolidation guidelines, but instead should focus on the operational aspects of the ratemaking areas.") (Referred to below as "Golden State's Opening Comments").

[3] DRA's Opening Comments, *supra* note 1, at 15 (stating, "particular thresholds in the 1992 Guidelines, *e.g.*, the 10 mile threshold suggested in the Proximity criterion and the 25 percent threshold suggested in the Rate Comparability criterion, may not be hard and fast indicators of the propriety of district consolidation in some instances."). While DRA recognizes that the 1992 Guidelines could be improved upon, it strongly opposes wholesale elimination of the 1992 Guidelines or any of the four current criteria.

showing the wide variance in average monthly customer bills in eight identified districts.[4] To the extent that California American Water is suggesting that the 1992 Guidelines be modified to not require or otherwise de-emphasize consideration of geographical[5] and/or water supply differences between districts – which presumably account for the wide variation in average monthly customer bills identified in the referenced table – DRA strongly opposes any such modification and rejects the presumption that all rates should be the same regardless of significant differences in these characteristics.

## II. DRA'S REPLY COMMENTS TO QUESTION 3

With respect to the 1992 Guidelines, the OIR also asks:

> *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.*

As explained in DRA's Opening Comments in this Rulemaking, the four criteria stated in the 1992 Guidelines sufficiently address the most significant considerations that should be analyzed in determining whether a proposed district consolidation will result in efficiencies and yield actual cost savings, and further, require analysis of many of the specific characteristics identified in Question 3.[6] DRA has, however, suggested three additional characteristics of water districts that could be considered by the Commission

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[4] California-American Water Company (U210W) In Response to Order Instituting Rulemaking R.11-11-008, March 1, 2012, at 4 (referred to below as "California American Water's Opening Comments").

[5] DRA's Opening Comments, *supra* note 1, at 16 (wherein DRA explains that consideration of a number of the water district characteristics identified in Question 3 of the OIR are, in fact, subsumed by the four criteria in the 1992 Guidelines, and, more specifically, that consideration of geography is "subsumed by the Water Supply criterion.").

[6] *Id.*

when deciding whether to approve a consolidation proposal: average water use, synergies, and average income level.[7]

DRA notes that other respondents to this Rulemaking have also proposed additional criteria for inclusion in the 1992 Guidelines. For example, California Water Service Company ("California Water") and California American Water have suggested that it may be possible to consolidate defined, uniform "base costs" across multiple districts, such as meter reading activities, billing, and customer service.[8] DRA would welcome the opportunity to discuss the possibility of refining and/or supplementing the 1992 Guidelines, including consideration of the consolidation of base cost categories, in workshops that could be conducted as part of this Rulemaking.[9] With respect to the latter, the primary question would be whether real economies of scale could be achieved through the consolidation of such base cost categories. DRA also notes that some of these basic cost categories, such as billing and customer service, are already provided for on a centralized basis by some of the large, multi-district water utilities.

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[7] *Id*. at 16-17.

[8] Opening Comments of California Water Service Company (U-60-W), R.11-11-008, March 1, 2012, at 7-9, (referred to below as "California Water's Opening Comments") (explaining, "[c]onsolidation by cost category can be considered based on the principle that the utility provides two distinct services. The services that are relatively uniform to each customer in each district ('base costs') and those services that vary significantly by district because of geography and topography manifested as supply, treatment, transmission, and storage costs ('supply costs'). The cost category consolidation concept would attempt to spread base costs evenly to all customers in all districts, but would retain supply costs as a part of the cost of service calculation for each district."); California American Water's Opening Comments, *supra* note 4, at 5 (stating, "there are costs that are common to all districts [that] could be shared or equalized between districts," and identifying the following examples of costs that would be appropriate for consolidation: meter reading, billing, collecting, customer accounting, call handling and the capital costs of service lines, meters and meter settings.).

[9] As both California Water Service Company and California-American Water Company identified meter reading activities as a cost category that would potentially be appropriate for consolidation, it is worth noting that DRA has reservations about the propriety of wide-scale implementation of automatic meter reading, or AMR, across multiple districts, as the reasonableness of such capital costs must be determined in relation to the particular circumstances of each individual district, *e.g.*, the historical difficulty and/or safety concerns associated with traditional meter reading.

By contrast, Golden State "proposes that the cost of all capital project items be captured at a company level and allocated to the ratemaking areas through the General Office allocation. . . . While expenses, including supply costs, would still be calculated by established rate making areas, thereby alleviating concerns related to disparate operating expenses such as the difference in supply sources."[10] DRA has serious reservations about the propriety of consolidating the cost of certain capital projects, *e.g.*, plant costs, across multiple districts, particularly where there are water supply differences that entail significant variation in the levels of such capital costs.

Similarly, San Gabriel Valley Water Company ("San Gabriel Valley Water") proposes that the Commission consider consolidating a broader array of cost categories across multiple districts served by the same water utility, suggesting, as an example, that "water and power costs could be charged only to the individual district while *the remaining costs* could be consolidated and spread over one or more districts for ratemaking purposes."[11] (emphasis added). To the extent that San Gabriel Valley Water is suggesting the consolidation of all capital costs across multiple districts, as noted, DRA has serious reservations about such a proposal.

Further, in response to Question 3, San Gabriel Valley Water also suggests that the Commission, "consider incentives to promote the takeover of willing small water utilities where the consolidation with a larger investor-owned water utility provides customers of the smaller utility with significant benefits such as access to capital for infrastructure, professional expertise, and economies of scale that cannot be realized because of the existing size."[12] DRA points out that consideration of policies to incentivize such

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[10] Golden State's Opening Comments, *supra* note 2, at 13.

[11] Opening Comments of San Gabriel Valley Water Company (U337W) In Response to Order Instituting Rulemaking, R.11-11-008, March 1, 2012, at 6, emphasis added (referred to below as "San Gabriel Valley's Opening Comments").

[12] *Id*. at 6.

acquisitions is beyond the scope of this Rulemaking. Moreover, given the complexity of the issue, DRA recommends that it be addressed in a separate Commission proceeding.[13]

## III. DRA's Reply Comments to Question 4

The OIR poses the following question:

*Question 4 – What advantages and disadvantages, if any, would result from implementing a "High-Cost" fund? How could such a "High-Cost" fund operate?*

For the reasons detailed in its Opening Comments in this Rulemaking, DRA does not support the establishment of a High-Cost fund to subsidize all areas in which the provision of water service is determined to be high-cost, as currently implemented in the telecommunications sector.[14] In short, if a telecommunications style High-Cost fund were to be funded by an end-user surcharge on all customers of Class A investor-owned water utilities, such a mechanism could easily become unreasonably complex, raise equity issues surrounding the appropriate allocation of collected funds among the various utilities, and fail to sufficiently address the affordability of rates.[15]

A more appropriate model for providing targeted assistance to low income, low consumption, and high-cost areas is the Rate Support Fund ("RSF") implemented by California Water Service Company ("California Water") in the Antelope Valley, Kern River Valley, and Redwood Valley water districts as a result of a settlement between DRA and California Water in 2006 ("California Water RSF").[16] DRA supports

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[13] Notably, the Commission addressed the potential need for "changes in regulations surrounding the acquisition or merger of public utility water systems" in R.97-10-048, which was opened on October 22, 1997. D.99-10-064, at 2.

[14] DRA's Opening Comments, *supra* note 1, at 18-25.

[15] *Id*.

[16] *Id*. at 22-23. *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 to DRA's Opening Comments, *supra* note 1.

intra-company mechanisms, like the California Water RSF, that utilize carefully designed district eligibility criteria, such as appropriate income thresholds and usage thresholds, and that account for extraordinary water quality challenges, to promote efficient water use and benefit areas where the affordability of water service is a real concern.[17]

DRA notes that California Water and Del Oro Water Company, Inc. are also opposed to the implementation of a telecommunications style High-Cost fund for water utilities,[18] and, further, that California American Water, the National Consumer Law Center (NCLC), and The Utility Reform Network (TURN) also support the Commission's broader implementation of a mechanism comparable to the California Water RSF under this Rulemaking.[19]

In the event that the Commission proceeds with the implementation of a telecommunications style High-Cost fund for water utilities as a result of this Rulemaking, DRA recommends that any such mechanism be narrowly tailored to achieve desired outcomes, *e.g*., increased affordability of rates, and to avoid negative ramifications identified by DRA and other respondents such as increased water usage, discouragement of conservation, encouragement of unsustainable development in high-cost areas with limited or less reliable water supplies, and less equitable rate structures.[20]

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[17] DRA's Opening Comments, *supra* note 1, at 24-27.

[18] California Water's Opening Comments, *supra* note 8, at 11-12 ("Given the many challenges associated with the current high cost funds for telephone companies, they do not appear to be appropriate models for the water industry."); Del Oro Water Company, Inc. Response to R.11-11-008, March 1, 2012, at 2 ("To generally answer questions 3 thru 8, Del Oro Water would prefer to not establish a 'High Cost' fund for its water district. Over 5,600 of the 8,100 customers that Del Oro services are located in Northern California, and a 'High Cost' Fund would create the region in Northern California subsidizing the remaining 2,500 customers located in Southern California.").

[19] California American Water's Opening Comments, *supra* note 4, at 6; Comments of the National Consumer Law Center and The Utility Reform Network, R.11-11-008, March 1, 2012, at 26.

[20] See *e.g*., Opening Comments of the Natural Resources Defense Council in Response to Order Instituting Rulemaking, R.11-11-008, March 1, 2012, at 3-4.

Respectfully submitted,

/s/ JONATHAN KNAPP

Jonathan Knapp
Staff Counsel

Attorney for the Division of Ratepayer Advocates

California Public Utilities Commission
505 Van Ness Ave.
San Francisco, CA 94102
Phone: (415) 703-5377
Fax: (415) 703-2262
Email: jonathan.knapp@cpuc.ca.gov

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