

Attachment A

Report on Balanced Rate Rulemaking

(R.11-11-008)

California Public Utilities Commission
Division of Water and Audits

January 30, 2014

Executive Summary

This report presents the Division of Water and Audits (DWA) evaluation and recommendations in Order Instituting Rulemaking (OIR) R.11-11-008 – a proceeding to address the Water Action Plan’s (WAP) sixth policy objective of setting rates that balance investment, conservation, and affordability for multi-district water utilities. The rulemaking’s scope was to consider adopting new or revised guidelines for consolidation of districts, some variation of a high cost fund within multi-district utilities, and another mechanism or a combination of them as a means to advance the Commission’s WAP objectives. Inter-company mechanisms were specifically excluded from the rulemaking.

The OIR invited the participants to file initial and reply comments to a series of questions regarding consolidation and high cost funds, four days of workshops were conducted, and a DWA developed High Cost / Affordability Framework was discussed. Twelve parties participated in the OIR.

DWA presented a draft staff report on July 12, 2013. Comments and Reply Comments were filed in response to the draft report. In response to comments, the report has been extensively revised. The report is now focused on the OIR’s scope as defined in the Assigned Commissioner’s Scoping Memo and Ruling dated June 21, 2012. This report does not attempt to capture every comment made by the parties in several rounds of comments and replies, and at the four days of workshops. The report now presents actionable options that the Commission may pursue in the resolution of this rulemaking. These options are based upon the vigorous workshop discussions and extensive comments filed in this proceeding. While parties have also requested that an all-party meeting with the Administrative Law Judge (ALJ) be convened before issuance of the final DWA report, such a meeting is not needed given the extensive revisions to the report.

The report finds that the Commission has many viable and actionable options with regard to a high cost fund and to district consolidation. Based on our discussion with the parties and a review of their comments, the Commission may wish to consider one or more of the following options for the establishment of a Rate Support Fund (RSF); (1) Authorize multi-district water utilities to propose a RSF mechanism for their districts; (2) Establish prescriptive guidelines for the RSF with regards to affordability, usage and subsidy type, and (3) Do not authorize any future RSF mechanisms, and instead, encourage district consolidation as a means to mitigate bills in high-cost districts.

The Commission may wish to consider one or more of the following options for the establishment of revised consolidation guidelines; (1) Retain the existing guidelines and continue evaluating consolidation requests on a case-by-case basis; (2) Eliminate the guidelines in their entirety and signal that the Commission is open to consolidation requests that balance investment, conservation and affordability; (3) Revise the guidelines to better reflect the adoption of new technology and of new regulatory goals to balance investment, conservation and affordability; y; and (4) Expand the existing guidelines to take into account additional factors such as the condition of infrastructure, the ability of customers to pay additional costs of improvements, and whether consolidation will improve the possibility of securing state and federal grants for improvements.

Rulemaking

On November 10, 2011, the Commission adopted Order Instituting Rulemaking (OIR) R.11-11-008, to initiate a proceeding to address the Commission's Water Action Plan's (WAP) sixth policy objective of setting rates that balance investment, conservation, and affordability for multi-district water utilities. The WAP¹ identified six actions for consideration as possible

¹ California Public Utilities Commission December 15, 2005 Water Action Plan, p. 20 and 21, the principles and objectives of which remain the same in its updated 2010 Water Action Plan, p. 7.

means to advance this objective, several of which have been examined in other proceedings, including the multi-district water utilities' general rate cases.

The OIR states in part:

“By initiating this OIR, we focus on this sixth objective of setting rates that balance investment, conservation, and affordability, with a focus on multi-district water utilities. We recognize that, while a core principle of establishing rates is to maintain rates that are “just and reasonable,” the application of this core principle (and the sixth objective of the Water Action Plan) can be challenging.

Among the actions listed to advance this objective is to consider the development of policies to subsidize high cost areas, either through some variation of a “High-Cost” fund or through consolidation of districts and rates...

As part of advancing the sixth objective in the Water Action Plan, the Commission will consider mechanisms such as a “High-Cost” fund or consolidating districts and rates within the multi-district water utilities. In this proceeding, the Commission will consider these mechanisms on a general policy basis and will not consider the application of the mechanisms to a specific multi-district utility. To the extent this Rulemaking results in the adoption of new mechanisms, utilities can include requests to utilize these mechanisms in their respective general rate cases or other appropriate rate-setting applications.”

The OIR's Preliminary Scoping Memo states in part “The scope of this rulemaking is to consider establishing new guidelines for consolidation of districts or for some variation of a “High-Cost” fund, within the multi-district water utilities, as a means to advance the Commission's Water Action Plan's objective of setting rates that balance investment, conservation, and affordability.” In addition, the OIR invited the

participants to file initial and reply comments to the following eight questions; (Twelve parties participated in the OIR.²)

Question 1 – Identify current mechanisms utilized to subsidize rates and prevent rate shock, such as low-income rates and rate support funds. Are these current mechanisms adequate to address ratepayer needs in general? Do these current mechanisms achieve an appropriate balance between utility investments, conservation and affordability of rates?

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?

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.

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

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

Question 6 - What impacts would increase 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

² Named participants include five multi-District utilities (California-American Water Company, California Water Service Company, Del Oro Water Company, Inc., Golden State Water Company, and San Gabriel Valley Water Company) and The Division of Ratepayer Advocates. Other interested parties are The Utility Reform Network (TURN), The National Consumer Law Center (NCLC), Natural Resources Defense Council, City of Visalia, County of Lake, and Jeffrey Young (a ratepayer).

mandated by Federal and State laws such as the Water Conservation Act of 2009?
Is it possible to effectively mitigate these impacts?

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

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

After opening comments and reply comments were filed, a Prehearing Conference (PHC) was held on May 27, 2012. Following the PHC, the assigned Commissioner issued a Scoping Memo and Ruling, dated June 20, 2012, which replaced the provisional Preliminary Scoping Memo in the previous paragraph with the following:

The scope of this rulemaking is to consider adopting new or revised guidelines for consolidation of districts, some variation of a high cost fund within multi-district utilities, and another mechanism or a combination of them as a means to advance the Commission's water action plan objective of setting rates that balance investment, conservation, and affordability. *Inter-company mechanisms will not be explored in this proceeding (emphasis added).* Any consideration of mechanisms in addition to consolidation guidelines and a High Cost variant will be informed and bounded by the analysis in this proceeding's workshops, data requests and responses, comments and reply comments, and other information submitted in the record of this proceeding."

The assigned Commissioner stated in her Scoping Memo and Ruling that this change was made because "Fruitful discussion during the PHC has convinced me that mechanisms for achieving the balanced rates objective of this rulemaking may not be mutually exclusive, may not be limited to consolidation guidelines and a High Cost Fund variant, and that intra-company mechanisms alone should be considered."

The Scoping Memo established a schedule for completion and included an opportunity for two workshops.

Workshops were convened by DWA Staff (Staff) on July 17-18, 2012, and again on November 6-7, 2012. During the first workshop, participants discussed Definitions of key terms, existing support mechanisms in the communications and water industries, guidelines that are currently used by the Commission in evaluating utility consolidations, the Commission's experiences in past consolidations, and additional factors that the Commission should consider when reviewing consolidation of districts of multi-district utilities. In the second workshop, participants discussed the principles that should govern consolidation of utility districts and an "Integrative Framework" proposal submitted by Staff to identify high cost districts in multi-district utilities, and considerations for a High Cost Fund for the water industry.

A two-track high cost and affordability integrative framework / decision tree was developed to provide a visual tool to evaluate high cost drivers and district conditions and to identify districts with potential high-cost and/or affordability issues. The high cost track identifies high-cost districts within a multi-district utility that have potential affordability issues. The affordability track identifies if utility customers in a district have affordability related issues that need remediation. The purpose of the Framework was to foster a discussion among the parties to address the scope of the rulemaking. No consensus was reached regarding the use of the Framework as a generic mechanism to be used by the water utilities for use in district consolidation.

The Framework is attached as Appendix A.

High Cost Fund within Multi-District Utilities

1. Telecommunications High Cost Funds

The workshop discussion of the issue of adopting a variation of a high-cost fund within multi-district utilities began with an overview presentation on the telecommunication industry's High Cost A and B Funds by the Commission's Communications Division. The High Cost Fund B provides a subsidy to identified-high cost service areas equal to the difference between a Commission-established cost benchmark for what is recoverable from a customer and the actual cost of serving the customer. Communication Division staff indicated that a B Fund model could be applicable to the multi-district water utilities if the Commission can: 1) identify the specific areas that are high cost and 2) establish a cost benchmark. The B Fund the benchmark was set at an average cost based on a state-wide cost study designed by the utilities.

Communications Division staff noted that high cost funds can affect various incentive mechanisms in the regulatory process. These funding mechanisms de-couple in the customer's mind the link between costs and rates in these high-cost areas. This can act to mute customer concerns and protests over increasing costs of providing service to these areas and thereby removes an important check on the utilities' requests for increased costs. The result noted by Communications Division staff is that high cost funds can incentivize utilities to over invest and for the Commission to more readily pass through revenue requirement increases than would be the case absent a high cost fund.

2. Water Industry High Cost Fund

California Water Service Company (Cal Water) presented an overview of its Rate Support Fund (RSF) that the Commission has authorized for three of its high-cost districts (Kern River Valley, Redwood Valley, and the Fremont Valley service area in Antelope Valley). Cal Water noted that these districts are all small systems with high rates, many low-income customers, immediate infrastructure needs for water quality or supply, and affordability concerns. Cal Water indicated that the starting point for the RSF was a rate base equalization account where

Cal Water would cap rate base per customer in these high-cost districts at Cal Water's system-average rate base.

Cal Water and the then Division of Ratepayer Advocates (now Office of Ratepayer Advocates (ORA)) crafted a joint agreement addressing ORA's concerns with Cal Water's rate base equalization proposal. The RSF contains a general support component for all customers in the identified high-cost districts.³ The current rate support is provided either in a monthly credit per service connection that ranges from \$12.10 to \$25.00 per month or through a volumetric credit per hundred cubic feet (Ccf) of \$10.37 and \$2.31 in the Coast Springs and Redwood Unified tariff areas, respectively, in the Redwood Valley District. These credits are funded through a quantity surcharge of \$0.01 per Ccf applicable to all metered customers except those participating in the Low-Income Ratepayer Assistance program.⁴

ORA and Cal Water examined a number of factors beyond the cost of water in identifying impacted high cost districts. ORA in its presentation identified affordability which it characterized generally as a function of customer income, customer usage, and cost of service as important factors to be jointly considered in identifying districts eligible for RSF assistance. This is generally echoed by Cal Water in its discussion of the lessons learned in designing and developing the RSF. In addition, Cal Water indicates an RSF mechanism will only work for a water system where the subsidy is large enough to be meaningful, but the cost to non-participating customers is low enough to not have them in opposition. Cal Water has the advantage of having 450,000 other customers supporting 7,000 customers in the RSF districts.

ORA raised several cautionary concerns when considering establishment and design of any sort of high cost fund, including: 1) the need for rate relief should be established where the program is not just subsidizing an area because it is high cost; 2) the subsidy should be granted

³ In the case of the Antelope Valley District, only customers in the Fremont Valley service area are subject to the support component in the RSF.

⁴ Analogous surcharges are applied monthly to flat-rate customers with the exception of customers in the Low-Income Ratepayer Assistance program.

short term to be reviewed and the need re-established in each subsequent general rate case; 3) the subsidies should not result in low income customers subsidizing high income or high usage customers; and 4) sustainable and efficient uses of water should always be encouraged.

3. High Cost Fund Issues and Parameters

During the course of the workshops parties discussed a number of issues and parameters surrounding the design and implementation of an intra-utility high cost fund for multi-district utilities along the lines of the RSF program developed by Cal Water and ORA. The following questions are identified in the workshop as needing to be addressed as part of the design and development of a RSF program.

3.1 Should the RSF Program Be Extended to Other Multi-District Utilities?

The Joint Consumers⁵ believe a program modeled after the RSF should be part of the Commission's regulatory options. (Joint Consumers Comments at p. 16) Cal-Am supports the limited use of an RSF where the Commission determines that a very high percentage of customers have affordability issues in paying their water bills and other measures, such as rate consolidation, are not warranted. (Cal-Am Comments at p.6). The City of Visalia does not support expansion of the RSF program in its current form as the existing program is subsidizing non-low-income customers that may not have affordability issues. Any expansion of the RSF program should be revised to ensure subsidy benefits are available to only qualified low-income customers. (Visalia Comments at p. 6) A number of participants also raise concerns about "payment-troubled" (LIRA and non-LIRA working poor) customers having to support customers who need no assistance. (Young Comments at p. 3, Joint Consumers Comments at p. 17). Cal Water indicates there is a limited appetite among non-participating customers to continue, much less expand, mechanisms to subsidize other customers with RSF. (Cal Water Reply Comments at p. 3). San Gabriel emphasizes that before mandating any utility to expend time and resources in examining the application of an RSF program, the

⁵ National Consumer Law Center and The Utility Reform Network

Commission consider the utility-specific circumstances. (San Gabriel Comments at p. 8). During Cal Water's workshop presentation, it cautions that the design and implementation of its RSF program is such that its applicability may be of limited use for other multi-district utilities. The idea that not all multi-district water utilities are similarly situated when it comes to the applicability of an RSF program is reiterated by San Gabriel. (San Gabriel Comments at p. 2).

3.2 Should the Commission Mandate Prescriptive RSF Guidelines?

Cal-Am states that the Commission should avoid mandating prescriptive guidelines and mechanisms given the varying differences in the issues facing each multi-district utility. (Cal-Am Comments at pp. 2-3). ORA, Cal Water, San Gabriel all agree that guidelines or guidance be kept relatively flexible to allow parties to tailor any program to the particular utility circumstances. TURN, however, would like the guidelines and guidance coming out of this Rulemaking to be fairly specific. Mr. Young argues that the criteria used in the past are subjective and suggests it may be better for the Commission to set out an objective set of criteria in advance to be used in general rate cases. The general consensus among workshop participants is that a utility's general rate case is the best venue for reviewing these matters as it allows parties and ultimately the Commission to review various regulatory mechanisms to address high cost and customer affordability as a package.

3.3 What Is an Appropriate Affordability Criterion for an RSF Program?

There are two explicit affordability criteria mentioned during the workshops. First, a recommendation by the California Department of Public Health that if a monthly water bill exceeds 2.5% of monthly median household income (used in the Framework), a customer's water service is not affordable. The U.S. Environmental Protection Agency's recommended figure for this metric is 1.5%. Mr. Young and the Joint Consumers support the lower 1.5% figure if an affordability criterion is included in any guidelines. (Young Comments at p. 2, Joint Consumers Reply Comments at p.9). However, the Joint Consumers raise concerns that

using median household income may not be sufficiently granular to accurately capture the affordability condition in each utility district. (Joint Consumers Reply Comments at p. 10)

3.4 What is an Appropriate Usage Criterion for Determining Affordability?

There is general consensus that any affordability criterion should be based on essential levels of indoor water use. It was argued that use of the average water bill to determine affordability could lead to subsidies to reduce the cost for outdoor water use. (NRDC Comments at p. 3). NRDC, Cal Water, and Joint Consumers all indicate that average winter water consumption is a valid proxy for indoor water use. (NRDC Comments at p. 5, Cal Water Comments at 3, Joint Consumers Comments at p. 13). However, there was no final recommendation on what this figure should be. ORA in its workshop presentation and Cal Water suggest looking at a usage criterion for affordability of 10 Ccf per month or less. This figure does not account for household size and may be very generous in certain situations and borderline in other areas. A 10 Ccf per month usage correlates to approximately 60 gallons per day per capita for a household of four people.

3.5 What is an Appropriate High Cost Criterion for an RSF Program?

There is general consensus that a high cost district metric should be based on a district's revenue requirement per Ccf of sales. This metric is preferred over the revenue requirement per customer (as contained in the Framework) as it overcomes analysis that may be skewed by differences in size and composition of a utility's customer base or in usage among customer classes. (San Gabriel Comments at p. 4, Golden State Comments at p. 15). San Gabriel cautions that the revenue requirement per Ccf is not without problems when it is applied in districts in vacation areas with a high number of customers but low seasonal usage. Visalia echoes the caution over the use of revenue requirement per Ccf. (Visalia Reply Comments at p.3). San Gabriel recommends both metrics should be considered in applying a high cost threshold. (San Gabriel Comments at p. 5) Cal Water shows that the four tariff areas with the highest revenue

requirement per Ccf match the four tariff areas receiving subsidy benefit under the RSF program. (Cal Water Reply Comments at Attachment A).

The second component to the design of a high cost criterion is the threshold that should be used for determining if a district or identified sub-area qualifies as a high-cost area. A figure used in workshop discussions is that a district that has revenue requirement per Ccf that is greater than 150% of the utility average revenue requirement per Ccf qualifies as a high cost district. (Golden State Comments at p. 18). The 150% figure is taken from the threshold that is used for the telecommunications High Cost A Fund. Joint Consumers indicate that the exact figure to be used was not settled, nor was there agreement on what to compare the revenue requirement per ccf figure against to determine what is a high-cost area, utility average or a particular geographic region. (Joint Consumers Comments at p. 14).

3.6 How Should the RSF Subsidy Be Designed?

Cal Water's current RSF program delivers the subsidy benefit either as uniform credit to the monthly service charge (Freemont Valley, Kern River Valley, and Lucerne) or a uniform quantity credit (Coast Springs and Redwood Unified).⁶ The Joint Consumers and Visalia urge that an RSF subsidy benefit should vary with income. (Joint Consumers Comments at p. 3, Visalia Reply Comments at p. 3).

In our examination of a high cost fund within multi-district utilities, we requested parties to comment on five questions posed in the OIR, we reviewed the telecommunication industry's high cost funds at our first workshop, and we discussed and received comments on the Rate Support Fund used by Cal Water. A number of themes emerged from our review and discussions. While there was some general consensus, there was less agreement on many of the issues posed in our questions and at our workshops.

⁶ In A. 12-07-007, a Settlement Agreement in Cal Water's current general rate case has been filed to amend the subsidy design for the RSF program whereby the RSF quantity rate would be set a 150% of the system-wide quantity rate. The RSF quantity rate would be applicable for the first 10 Ccf of usage (4 Ccf for Coast Springs). All usage above 10 Ccf would be charged at the a full quantity rate for the district or tariff area.

The Cal Water RSF was used as the proxy for discussion of a high cost fund. ORA and Cal Water described at length how the RSF was established and the factors considered in its development. The parties used the RSF program to discuss the design and implementation of intra-utility high cost fund. A number of issues were raised including extension of the RSF to other utilities, whether prescriptive RSF guidelines should be established, affordability and usage criterion to be used, and subsidy designs.

Based on our extensive discussion with the parties and a review of their comments, the Commission may wish to consider the following options for the establishment of an RSF.

Option #1: Authorize multi-district water utilities to propose a RSF mechanism for their districts. Such a proposal should be filed as a part of a general rate case proceeding. Review and evaluate RSF requests on an individual basis. Do not mandate prescriptive guidelines for the RSF with regards to affordability, usage and subsidy type.

Option #2: Establish prescriptive guidelines for the RSF with regards to affordability, usage and subsidy type. Require that future RSF requests meet the established guidelines. For example, the RSF benefit provided could decline with increasing income. An RSF could also exempt low-income customers outside of the RSF area from contributing to the RSF.

Option #3: Do not authorize any future RSF mechanisms. Instead, encourage district consolidation as a means to mitigate bills in high-cost districts.

Consolidation

Water rates for multi-district investor-owned water utilities in California are set and approved by the Commission for each district. Each district is “stand alone”, has distinct

characteristics and, may or may not be contiguous to other districts in the utility system or be physically interconnected.⁷ Each district has a unique revenue requirement and rates that are established through a general rate case every three years. The Commission may permit cross-subsidization between customers when considering consolidation if it determines that such an action is justified.⁸ Consolidation in multi-district utilities may be accomplished through: (1) rate consolidation; (2) cost consolidation; (3) rate base consolidation; and (4) operational consolidation.

1.2 Role of the 1992 Consolidation guidelines relative to balanced rates

In 1992, the Division of Ratepayer Advocates and the Class A water utilities jointly developed a set of policy guidelines to be considered in district rate consolidations. These guidelines established four criteria; proximity, rate comparability, water supply and operation, as detailed in D. 05-09-004:

1. *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 which are not connected. It was suggested that districts within 10 miles of each other would meet the location criteria.
2. *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.
3. *Water Supply*: Sources of supply should be similar. If one district is virtually dependent upon purchased water, while another district has its

⁷ “Physically interconnected systems” are water systems that are joined by a system of pipes and pumps for transporting water (usually treated water) from one system to another”. Source: *EPA/NARUC Report*, Appendix A: Glossary p.74.

⁸ Rulemaking at 4 –“In the Water Action Plan, the Commission stated that it would determine whether and when cross-subsidization between customers is justified.”

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.

4. *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.”

In D.05-09-004, the Commission stated that the guidelines were intended to set criteria for single tariff pricing that, when met, would establish prima facie reasonableness of the proposed consolidation. The Commission concluded that, while not determinative, the criteria were helpful in evaluating rate consolidation proposals.

During the first workshop, there was extensive discussion of the history, background and experiences with the 1992 Consolidation guidelines. Past consolidation efforts were discussed by DRA, GSWC, Cal-Am and Cal Water. During the workshops, it was pointed out that although the district-by-district rate setting process remains the standard, the Commission has also made exceptions to this approach. For example, in 1994, the Commission approved Golden State Water Company (GSWC)’s request to consolidate its 16 districts into three regions while continuing to keep the ratemaking process at the district level.⁹ ¹⁰ Similarly, in 2010, the Commission approved the consolidation of California Water Service Company (Cal Water)’s request to consolidate two of its districts into a single new

⁹ Region I included water operations located in the central and northern portions of California. Region II included water operations located in or near the South Bay area of Los Angeles County. Region III included water operations located in the mountains and upper desert areas of Southern California, portions of Orange County, and a number of cities in the Inland Empire region of Los Angeles. (Exhibit 1 of GSWC to Investigation 07-01-022).

¹⁰ GSWC states: “the regionalization in 1994 had no effect on the number of ratemaking areas in its system until 1999, when it consolidated its eight ratemaking districts in its Region III into a single region-wide ratemaking area with uniform tariffs. Because of the disparity in the rates of the eight districts in Region III at that time, the Commission adopted a phase-in plan to transition the individual ratemaking areas to regional tariffs. The tariff rates for those districts whose rates were above the regional-wide tariffs were frozen until the region-wide tariffs increased and reached the level of the frozen districts’ rates. This consolidation of districts in Region III reduced the number of GSWC’s 16 ratemaking areas to nine overriding the 1992 guidelines.” See GSWC opening comments on Staff’s Draft Report.

district, and establish uniform tariffs for this new district.¹¹ The Commission again applied the 1992 guidelines in D.08-05-018 when it declined to adopt Cal-Am's request to consolidate its Sacramento and Larkfield districts.¹²

Types of Consolidation

Consolidation in multi-district utilities may be accomplished through: (1) rate consolidation; (2) cost consolidation; (3) rate base consolidation; and (4) operational consolidation.

Rate Consolidation/Single Tariff Pricing

Intra-Utility rate consolidation involves the use of a unified rate structure for multi-district water utility systems that are owned and operated by a single utility. Single tariff pricing aggregates and allocates costs over a broader customer base. Under this system, all customers pay the same tariff rate for service within the district.¹³

Benefits of rate consolidation include spreading fixed infrastructure costs and costs for common functions such as billing and customer service over a larger customer base. These help to stabilize rates and revenues, mitigate rate shock, smooth rate increases and improve affordability especially for small high cost systems. The centralized management and planning functions also help with better planning of investment in water supply infrastructure and more streamlined regulatory, administration and operational activities. The rate and revenue stability may benefit low-income households who can now plan for these expenses and operate under restrictive budgets.

¹¹ Decision 10-12-017, at 20. The Commission approved the consolidation of these districts as part of a settlement between the Division of Ratepayer Advocates and California Water Service Company.

¹² D. 08-05-018, at 32.

¹³ GSWC stated in its opening comments that "the use of the word "district" is not consistent throughout various Commission proceedings. For example, in 1999 the Commission authorized GSWC to consolidate its eight ratemaking districts in its Region III into a single region-wide ratemaking area with uniform tariffs. GSWC referred to these ratemaking districts as ratemaking areas which fell within three operating districts. In this case all customers pay the same tariff rate for service within the same region covering three operating districts covering eight customer service areas".

A disadvantage of rate consolidation is that it undermines efficient water use and conservation efforts by weakening price signals in high cost areas. By designing the rate structure at the company-wide level rather than at the local level, the connection between the cost of providing service and rates at the local level is weakened. This can partially be overcome through rate design and tiered pricing. The cross-subsidization of customers in high cost areas by customers in lower cost areas breaks the connection between costs and rates and may encourage overinvestment in infrastructure. Growth in high cost areas is encouraged, leading developers and potential residents to fail to take into account the full costs of water, disrupting price signals, imposing subsidy costs on others who live in lower cost areas, and potentially causing costly long-term impacts on water supplies of high cost systems with scarce sources of supply.

Cost Consolidation

Cost consolidation involves the aggregation of selected cost categories across certain service districts for ratemaking purposes. Cost consolidation helps stabilize costs in high cost districts, has less impact on larger districts and does not fully eliminate the traditional “cost-of-service” approach. Parties have commented that a possible disadvantage of cost consolidation is that low-cost areas may subsidize high-cost areas. Concern was expressed that price signals to customers might be impacted, thought to a lesser degree than full consolidation and there may result cost allocation issues.

Rate Base Consolidation

Rate base consolidation refers to the consolidation of the rate base across districts, while leaving in place the expenses for each district. This type of consolidation may alleviate the cost impact resulting from significant increases in plant investment; mitigation of the impact of

rate-shock in districts with a low number of service connections and large infrastructure needs; promotion of investment in water infrastructure, and assistance with compliance with water quality regulatory standards. The disadvantages of rate base consolidation include: weakening price signals and conservation efforts; misrepresenting the true cost-of-service, creating cost allocation issues and encouraging over investment in water systems. That said, regulatory oversight can minimize these impacts.

Operational Consolidation

Operational consolidation combines districts on an operational level while retaining a stand-alone revenue requirement for each district for ratemaking purposes. This is an existing characteristic of multi-district utilities. Operational consolidation pools common resources and may result in improved quality of service, cost savings and better access to reliable water supplies. If not properly addressed, disadvantages could include loss of local presence, diminished relationship between the utility and cities / counties with jurisdiction over district areas, and a requirement of separate accounting.

The Rulemaking at p. 7 states “We institute this Rulemaking to consider modifying the 1992 guidelines or establishing new consolidation guidelines for high cost areas for the multi-district water utilities.” While some parties prefer that the Commission retain the four guidelines, other parties are open to some modification of the guidelines to reflect the passage of over 20 years and the changes in technology and regulatory mechanisms, including the emphasis of water conservation and more stringent water quality requirements. The parties generally agree that the 1992 guidelines are not dispositive, but instead are guidelines for informing the Commission in making decision on utility applications for consolidation.

San Gabriel is the only water utility that recommends no changes to the guidelines. This is unlike Cal-Am that states “the guidelines are outdated in their entirety and fail to recognize the significant changes to the water industry since these guidelines were first established in

1992.” The Joint Consumers¹⁴ indicated that the Commission should supplement its evaluation of consolidations with an evaluation of the following additional information: 1) condition of the infrastructure; 2) the ability of customers in each affected district to pay additional costs of improvements; 3) whether customers in the consolidated and unconsolidated districts will continue to pay just and reasonable rates for appropriate terms of service; 4) whether consolidation will improve the possibility of securing state and federal grants for improvements; 5) the impact of any new debt required for system improvements on customer bills because of consolidation; and 6) whether consolidation will reduce expenses to counteract new debt, 7) technically capable staff, and 8) how customers will react and be impacted.

The 1992 guidelines are used to evaluate consolidation requests, some of which are approved while others are denied. In the absence of updated guidelines, the existing guidelines become a convenient “fall-back” position for utilities, parties and the Commission alike. This rulemaking was established to specifically examine whether modifications and/or new guidelines are warranted in today’s environment. At the time the guidelines were established, the water utility business was more “hands-on” in nature and technology solutions that we take for granted today; such as remote meter reading, remote monitoring of water tank levels / pump operations, cell phones, broadband connections, etc., mostly did not exist in utility operations. Several parties generally agree that the Proximity guideline is “less relevant than the other criteria¹⁵,” and DRA has suggested that the Proximity and rate Comparability criteria may not be “hard and fast indicators.”¹⁶ The City of Visalia prefers that the guidelines be retained as is.

Similarly, the Operation guideline states that the districts “should be operated in a similar manner,” and gives an example of two or more districts operated by the same manager with a

¹⁴ Joint Consumers comments at P.19

¹⁵ Joint Consumers at P. 22

¹⁶ DRA Comments at P. 15

common billing system. Like the Proximity guideline, this guideline is not as critical as it once was with availability of technology.

The Rate Comparability guideline requires that district rates be within 25% of each other and it recommends the phasing in of rates when possible. Strictly applied, this guideline may result in unintended consequences such as precluding the consolidation of a high cost area with a lower cost area, even if the high cost area was low-income. Cal-Am states that the 25% threshold figure will preclude any further consolidation among its districts¹⁷.

The Water Supply guideline requires that water supply sources should be similar. The concern is that if two districts are combined and one purchases water from a wholesale agency and another pumps water from a non-adjudicated basin, the water supply costs will potentially differ greatly and an inequity will arise. NRDC especially supports the retention of the Water Supply guideline as water costs have a “substantial bearing on current and future rates.”

Based on our extensive discussion with the parties and a review of their comments the 1992 consolidation guidelines are ripe for revision. The Commission may wish to consider one or more of the following options for the establishment of revised guidelines:

Option #1: Retain the existing guidelines and continue evaluating consolidation requests on a case-by-case basis. This option retains the status quo.

Option #2: Eliminate the guidelines in their entirety and signal that the Commission is open to consolidation requests that balance investment, conservation and affordability.

Option #3: Revise the guidelines to better reflect the adoption of new technology and of new regulatory goals to balance investment, conservation and affordability. For example, one or more of the guidelines, such as the Proximity / Rate Comparability /

¹⁷ Cal-Am comments at P. 4

Operation guidelines, could be struck and consolidation requests could be weighed against the remaining guidelines.

Option #4: Expand the existing guidelines to take into account additional factors. For example, the condition of the infrastructure, the ability of customers in each affected district to pay additional costs of improvements, or whether consolidation will improve the possibility of securing state and federal grants for improvements.

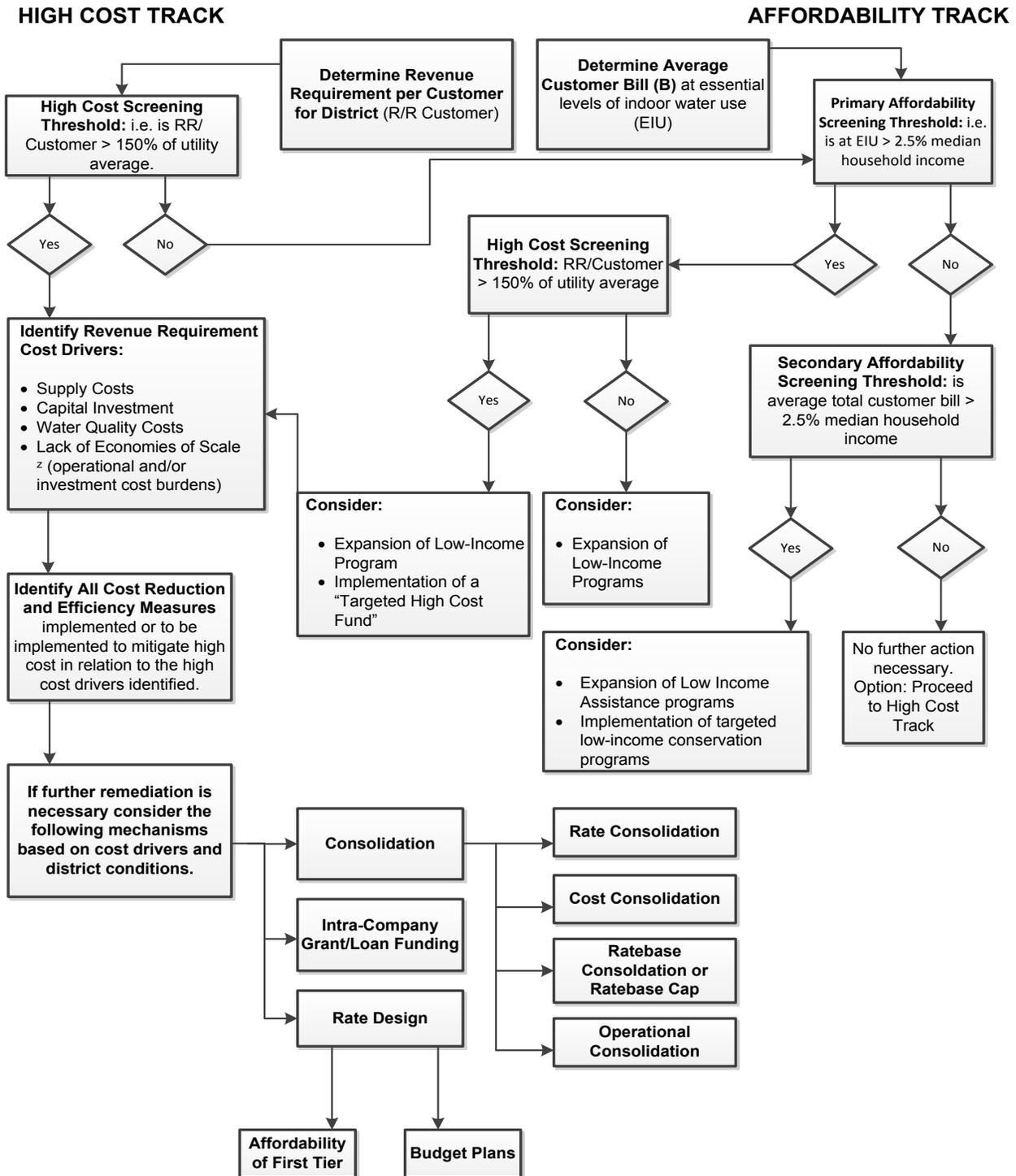
Appendix A

High Cost and Affordability Screening Framework

The purpose of the high-cost track is to identify high-cost districts in a multi-district utility and determine the remediation options available to provide relief to customers in those districts. To apply the high-cost track filters, the utility determines the revenue requirement per customer and compares it with the average revenue requirement across the utility's entire service territory.

The purpose of the affordability track is to determine if the utility customer is foregoing basic necessities to afford water service and to make a determination regarding the need to expand existing low-income assistance programs.

DATA FOR SCREENING REQUIREMENTS



End of Appendix A