

PROPOSED RESOLUTION

Resolution W-5042
DWA

Agenda ID #13934 (Rev. 1)

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

DIVISION OF WATER AND AUDITS
Water and Sewer Advisory Branch

RESOLUTION W-5042
June 11, 2015

RESOLUTION

(RES. W- 5042). CALIFORNIA AMERICAN WATER COMPANY, ORDER APPROVING CALIFORNIA AMERICAN WATER COMPANY'S REQUEST TO ACQUIRE OX BOW MUTUAL WATER COMPANY.

By Advice Letter No. 1066-W filed on December 31, 2014.

SUMMARY

This Resolution approves California-American Water Company's (Cal Am) request to acquire Ox Bow Mutual Water Company (Ox Bow) under the terms and conditions set forth in Advice Letter 1066-W and approved herein. The approved acquisition is in the public interest because it will allow Cal Am to utilize economies of scale as it adds the ninety-six Ox Bow connections to its existing 64,000 Cal Am customers and maximizes its resources to maintain a safe and reliable water supply. Water supplied from Ox Bow's wells currently exceeds the maximum contaminate level for arsenic. Cal Am will use its arsenic treatment plant in nearby Isleton to treat Ox Bow's water and the treatment costs will be spread throughout the larger customer base. With only ninety-six customers (95 residential and 1 commercial), Ox Bow is faced with recovering its fixed costs from too few customers. Cal Am is well positioned to share economies of scale with Ox Bow since Cal Am's service territory is about one mile across open farmland from Ox Bow.

Approval of this acquisition is consistent with the Division of Water and Audits (DWA) and the California Public Utilities Commission's (CPUC) commitment to evaluating the safety considerations of all Commission Resolutions and Decisions since the acquisition will ensure a safe drinking water supply, at reasonable rates, for the Ox Bow customers.

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BACKGROUND

Pursuant to Section 5 of General Order No. 96-B, Section 8.1 of the Water Industry Rules in General Order 96-B, and Appendix D to Decision (D.)99-10-064, Cal Am filed Advice Letter (AL) 1066-W on December 31, 2014, requesting authorization from the California Public Utilities Commission (CPUC) to (1) incorporate Ox Bow into the Sacramento District service area for both operational and rate-making purposes; (2) apply the tariff rates applicable for Cal Am's Sacramento District to the customers of Ox Bow upon the effective date of the completion of the final sales documents; and (3) use the purchase price of \$495,000 paid for the system as the regulatory rate base at the time of acquisition.

The December 31, 2014 AL was served on the Ox Bow customers, but not the existing Cal Am customers. Since the requested Ox Bow acquisition will increase rates to the existing Cal Am customers, albeit by only 2 cents per month per bill, Cal Am was directed to serve all of its existing customers with notice of the AL. On February 12, 2015, Cal Am noticed its existing Cal Am customers.¹

RESPONSE/PROTEST

Five responses were received from existing Cal Am customers. Three of the customer responses complained of the discrepancy between Cal Am's filing on December 31, 2014 and the mailing of the Notice on February 12, 2015 – without any explanation by Cal Am about the lag in the dates or without any clear indication of when the protest period ended. The Division of Water and Audits (DWA) will ensure that future notices are clear on applicable dates and when the protest period ends.

One customer response only raised a concern about increased water rates and how hard any rate increase was on low-income families. Another response questioned whether the AL process was appropriate for a rate increase request instead or requiring Cal Am to file a formal application. This customer complained that when Cal Am bought

¹ The February 12, 2015 Notice by Cal Am did not alert Cal Am customers to when the 20-day protest period ran so the Commission accepted all protests as timely that were received before March 6, 2015.

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another water district it resulted in her bills being tripled over a ten-year time frame. This customer fears that the relatively low rate increase Cal Am specified in its notice would balloon into a large rate increase in the future. As this customer opined, non-Ox Bow customers should not have to pay for Ox Bow costs.

Another Cal Am customer requested that DWA reject the Ox Bow merger since Cal Am rates have been escalating and he wonders where the benefits are for customers from the rate increases. He does not want his water rates to be used to bail out Ox Bow.

Cal Am did not reply to the responses.

DWA thoroughly reviewed and considered the responses, but none of the complaints presented warrant rejection of the Ox Bow acquisition. DWA and the Commission, however, are mindful of the impact any rate increase will have on existing Cal Am customers, and will monitor any future rate increase requests to ensure that the projected 2 cents per month per customer is the cost of the Ox Bow acquisition.

DISCUSSION

Ox Bow is currently a Mutual Water Company approximately one mile from Cal Am's Isleton water system, a component of Cal Am's Sacramento District. Presently, Ox Bow provides domestic water service to its ninety-six customers by way of a water system consisting of wells, mains, distribution lines and other facilities. The water Ox Bow is currently providing to its customers exceeds the maximum contaminate level for arsenic.

The State of California and the California Public Utilities Commission (CPUC) promote mergers of water systems especially when small systems can no longer economically provide adequate and safe water supplies. In Resolution No. 2008-0048 the State Water Resources Control Board (SWRCB) noted that small or disadvantaged communities cannot "provide the economies of scale necessary to build and maintain adequate water and wastewater systems." The final California Water Action Plan, released in

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October 13, endorses multiple approaches for guaranteeing all Californians' right to safe, clean, and affordable water.²

The CPUC in its 2010 Water Action Plan supported "incentives for the acquisition or the operation of small water and sewer utilities, in recognition of the benefits to customers of such acquisitions."³ Following up on this public policy goal, in October 2014, the CPUC issued D.14-10-008 which provided guidance to CPUC-regulated, multi-district water utilities on what factors to evaluate when proposing consolidation. The Decision clearly stated that the guidelines were not to be seen or used as "hurdles" for parties proposing consolidation, but were factors to be considered in determining whether the consolidation was in the public interest. (D. 14-10-008, at p.8) The factors to be evaluated for consolidation are: (1) proximity; (2) rate comparability; (3) water supply, and (4) operation. (D. 14-10-008 at p. 8)

Cal Am's Proposed Acquisition of Ox Bow

As discussed, Ox Bow has a small customer base of ninety-six customers. In its Sacramento District, Cal Am has over 64,000 customers and in its California service territory has over 600,000 customers. When Cal Am's AL request for acquisition of Ox Bow is evaluated in light of the state policy favoring the merger of small water districts, it is clear that consolidation is in the interest of the Ox Bow customers, with minimal negative effects on its current Cal Am customers, and will advance important State goals. In particular, Cal Am's purchase of Ox Bow will promote access to safe and reliable water service at reasonable rates for the Ox Bow customers. When the four guidelines from D. 14-10-008 are applied to the Ox Bow acquisition, proximity, rate comparability, water supply and operation, we are persuaded that all four principals are met. Ox Bow is just 1-mile from Cal Am's system; as discussed below, when

² Released by the California Natural Resources Agency, the California Environmental Protection Agency, and the California Department of Food and Agriculture and is available at the following link: <http://resources.ca.gov/california-water-action-plan/>

³ 2010 CPUC Water Action Plan, p. 9. The original plan was adopted by the CPUC in 2005 and updated on October 28, 2010. The updated Water Action Plan is available at this link: <http://docs.cpuc.ca.gov/PUBLISHED/Graphics/125501.PDF> 2010 Water Action Plan, p. 4.

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Cal Am's rates are imposed on Ox Bow customers the difference is acceptable; Cal Am will ensure a reliable, safe water supply (without unacceptable arsenic contaminate levels; and Cal Am provides a large, efficient operation to utilize for the ninety-six Ox Bow customers.

Cal Am has the financial resources and operating expertise to take over the Ox Bow system and ensure that the system produces safe drinking water that complies with stringent state and federal standards. This is particularly essential in the context of the arsenic mitigation. Ox Bow is not well-equipped to address the arsenic problem and it would be unrealistic to expect the ninety-six Ox Bow customers to foot the bill for this treatment protocol

The acquisition of Ox Bow will also benefit the Ox Bow customers in other ways. For example, Cal Am has a more specialized work force and access to newer and more advanced equipment and technology. These factors are important in regards to the arsenic eradication. The arsenic treatment plant Cal Am operates in Isleton has sufficient capacity to provide for the current Ox Bow customers at the existing fixed cost. Thus the Ox Bow customers will receive treated water without bearing the full cost of having its own arsenic treatment plant.

In addition, Cal Am has the ability to utilize quantity discounts and other economies of scale in purchasing resources/materials/supplies. And most importantly, Cal Am will be able to spread the high fixed costs of providing water service among a significantly larger customer base, in contrast to Ox Bow having to recover its high fixed costs from just ninety-six customers. As Cal Am argued in its AL filing, its acquisition of Ox Bow will allow Cal Am to mitigate customer costs per customer to (1) comply with regulatory requirements, (2) maintain customer information and billing systems, (3) purchase adequate materials and supplies, (4) maintain high levels of customer service, (5) maintain and improve quality of treated water and a continuous access to high quality water supplies, (6) provide for current infrastructure needs and future growth, and (7) support a level of expertise required to navigate the often complex requirements for government sponsored or required programs. (AL No. 1066, p. 3.)

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Benefit to Current Cal Am Customers

Ox Bow is currently seeking financial assistance from the SWRCB through Proposition 84, Section 75022 to construct a transmission main from the Isleton water system to the Ox Bow water system and to install service meters. SWRCB has issued a Letter of Commitment for the amount of \$2,985,000 for the Proposition 84 funding for these improvements. However, SWRCB will not release the Proposition 84 funds to Ox Bow until the CPUC approves the consolidation of Ox Bow with Cal Am.

If the CPUC approves the acquisition of Ox Bow, then Ox Bow will utilize the SWRCB funding to complete the system improvements which will enable the Ox Bow system to be served by the Isleton system. Then, upon the closing of the acquisition of Ox Bow by Cal Am, Cal Am will become the owner of the improvements. Cal Am specifies in AL No. 1066 that it will treat these Proposition 84-funded improvements as contributed plant and will not be included in Cal Am's regulated rate base. Cal Am current customers receive the benefit of almost \$3 million dollars in new assets, at no cost. Proposition 84 financial assistance would not be available to Cal Am, but is to Ox Bow. Ox Bow will use the money for the system improvements that will benefit the whole system.

Therefore, current Cal Am customers will not be paying for the system improvements involved in the consolidation of the smaller Ox Bow system with the current Cal Am system. In addition, existing infrastructure of Ox Bow's water system, including but not limited to wells, tanks, pumping equipment, electrical equipment, and piping shall remain in service upon the closing of the sale to Cal Am. Therefore, there are no immediate anticipated additional costs that Cal Am will have to expend in folding the Ox Bow system into Cal Am's Sacramento District.

OX BOW RATES

As part of its authorization request in AL 1066-W, once the acquisition of Ox Bow is complete, Cal Am seeks authorization to subject the Ox Bow customers to the tariffs generally applicable for Cal Am's Sacramento District customers, as amended from time to time. Currently, Ox Bow customers are unmetered and are subject to a flat monthly

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charge. Conversely, Cal Am's tariff rates have two components; a flat monthly charge and a usage-based component, which encourages conservation. Pursuant to the terms of the agreement Cal Am has with Ox Bow, Ox Bow will install meters, at its own cost utilizing Proposition 84 funds, for all unmetered services prior to the closing of the sale.

Impacts of the transition from Ox Bow rates to Cal Am rates will now vary, depending on a customer's usage. As of January, 2015, Ox Bow customers pay a flat rate of \$33.54 per month for service. Cal Am customers pay a \$16.93 monthly meter charge (5/8 inch meter) plus \$0.3501 for each CGL (100 gallons) of water consumed, plus \$0.0432 per CGL in approved surcharges. By example, a Cal Am customer using 5,000 gallons per month would pay a total monthly bill of \$36.59, while a customer using 10,000 gallons per month will pay \$56.24. These current rate levels do not reflect future rate changes necessitated by investments and expenses related to water quality and/or other issues.

ACQUISITION AGREEMENT

Under the Acquisition Agreement, Cal Am is to pay \$495,000 for the Ox Bow water system assets. As Cal Am set forth in AL 1066-W, consistent with D. 99-10-064, Section 2.04, the full purchase price of \$495,000 shall be recognized as the rate base for the acquired assets. Cal Am states that the purchase price was determined by fair negotiations between the parties and is supported by a valuation study accepted by both parties. Cal Am contends the requested rate base per customer for Ox Bow is comparable to the current rate base per customer for the Sacramento District.

Cal Am provided all its workpapers in support of its AL filing, with those documents containing confidential information provided under seal pursuant to GO 66-C and Section 583 of the California Public Utilities Code.

SAFETY CONSIDERATIONS

Currently, the water Ox Bow is supplying to its customers exceeds the maximum level for arsenic. With only ninety-six customers, Ox Bow clearly does not have the financial wherewithal to have its own arsenic treatment plant. By approving the merger of Ox Bow with Cal Am, the Ox Bow customers will have the benefit of SAFE drinking water

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as the water can be pumped through Cal Am's existing arsenic treatment plant in nearby Isleton – just one mile away. Therefore, in reviewing AL 1066-W for safety considerations, DWA found it was clear that approving the acquisition was in the interest of safety.

CONCLUSION

DWA thoroughly reviewed Cal Am's AL 1066-W filing, including all workpapers, and is persuaded that Cal Am's requested acquisition of Ox Bow is in the public interest and will ensure a supply of reliable, quality water to the Ox Bow customers, without any significant burden on the existing Cal Am Sacramento District customers.

COMMENTS

Public Utilities Code Section 311(g)(1) provides that resolutions generally must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Accordingly, this proposed resolution is mailed to the Advice Letter service list for comment on May 12, 2015.

No comments were received.

FINDINGS AND CONCLUSIONS

1. On December 31, 2014, California-American Water Company (Cal Am) filed Advice Letter(AL) 1066-W requesting authorization to acquire Ox Bow Mutual Water Company (Ox Bow), for a purchase price of \$495,000, under the terms and conditions set forth within the filing.
2. Cal Am served AL 1066 on its service list and on the Ox Bow customers. Cal Am did not serve the AL on its existing Cal Am customers. Because the Ox Bow acquisition will increase rates to the existing Cal Am Sacramento District customers, Cal Am was directed by the Division of Water and Audits (DWA) to serve AL 1066-W on all its existing Sacramento District customers. Cal Am effectuated this service on February 12, 2015.

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3. AL 1066-W requests authorization to (1) incorporate Ox Bow into Cal Am's existing Sacramento District for both operational and rate-making purposes; (2) apply the tariff rates applicable for Cal Am's Sacramento District to the customers of Ox Bow upon the effective date of the completion of the sales documents; and (3) use the purchase price paid for the system as the regulatory rate base at the time of acquisition.
4. Ox Bow currently has 96 customers (95 residential and 1 commercial). Cal Am has over 64,000 customers in its Sacramento District.
5. Water supplied by Ox Bow from its wells to its current customers exceeds the maximum contaminate level for arsenic. Ox Bow does not have an arsenic treatment plant. Cal Am has an arsenic treatment in its nearby Isleton system with sufficient capacity to provide for the needs of the Ox Bow customers.
6. Cal Am has the financial resources and operating expertise, a more specialized work force and access to newer and more advanced technology and equipment, and the ability to utilize economies of scale in obtaining discounts for purchasing resources/materials/supplies to take over the Ox Bow system.
7. Ox Bow is seeking financial assistance from the State Water Resources Control Board (SWRCB) through Proposition 84, Section 75022 to construct a transmission main to connect the Ox Bow system to Cal Am's system at Isleton and to install service meters. SWRCB has issued a letter of Commitment for \$2,985,000, but will not release the funds until the California Public Utilities Commission (CPUC) approves the acquisition of Ox Bow by Cal Am.
8. If the CPUC approves the acquisition of Ox Bow, SWRCB will release the funds, Ox Bow will complete the system improvements, and then at the closing of the acquisition, Cal Am will become the owner of the improvements. These Proposition 84-funded improvements will be treated by Cal Am as contributed assets and will not be included in Cal Am's regulated rate base.
9. Neither Cal Am nor Ox Bow customers will be paying for these system improvements, but these Proposition 84-funded improvements will allow Ox Bow to be folded into the Cal Am Sacramento District system and Ox Bow will keep all its existing infrastructure in service at the closing of the sale to Cal Am.

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10. When SWRCB releases the Proposition 84 funds, Ox Bow will also install service meters for all its customers. Currently, with no service meters, Ox Bow customers pay a flat rate. Once the Cal Am acquisition is complete and meters are installed, Ox Bow customers will pay a monthly meter charge and a usage charge based on the amount of water used by a customer. It is anticipated that Ox Bow customers' bills will increase, but the increase is reasonable in light of the fact that the Ox Bow customers will now be receiving a safe and reliable supply of drinking water, without the unacceptable levels of arsenic contaminate present in the current water.
11. Cal Am presented the Acquisition Agreement and workpapers in support of the acquisition request as part of its AL 1066-W filing. DWA has thoroughly reviewed the complete filing and finds it is reasonable and in the public interest to approve the requested acquisition.
12. Approval of the requested acquisition of Ox Bow by Cal Am promotes the interests of safety and ensures that the customers of Ox Bow receive a safe and reliable supply of drinking water at a reasonable rate, and without unacceptable levels of arsenic contamination.
13. Cal Am should file a Tier 1 Advice Letter that provides details of the finalized purchase and updates exemplary tariffs. The updated exemplary tariffs shall become effective five days after Cal Am files the AL.

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THEREFORE, IT IS ORDERED THAT:

1. California-American Water Company's request for authorization to acquire Ox Bow Mutual Water Company under the terms and conditions set forth in Advice Letter 1066-W is granted.
2. California-American Water Company shall file a Tier 1 Advice Letter that provides details of the finalized purchase and updates exemplary tariffs. The exemplary tariffs shall become effective five days after California-American Water Company files the Advice Letter.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on June 11, 2015; the following Commissioners voting favorably thereon:

TIMOTHY J. SULLIVAN
Executive Director

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