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MAILED 10/22/99

Decision 99-10-064 October 21, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the
Commission's Own Motion to Set Rules and to
Provide Guidelines for the Acquisition and
Mergers of Water Companies.

Rulemaking 97-10-048
(Filed October 22, 1997)

(Appearances are listed in Appendix A.)

OPINION

Summary

We opened this rulemaking proceeding to address issues arising out of our Water Division roundtable discussion and workshops regarding the need for changes in regulations surrounding the acquisition or merger of public utility water systems. Shortly after this proceeding was opened, the Legislature enacted Senate Bill 1268 to add Pub. Util. Code §§ 2718, et seq., the Public Water System Investment and Consolidation Act, effective January 1, 1998 (Appendix B). This Act requires that any water corporation acquiring a public water system use the fair market value as the rate base value of the acquired distribution system. Legislators enacted this Act to aid water systems in making infrastructure improvements, to meet increasingly stringent state and federal drinking water laws, to recognize that economies of scale are achievable in the operation of public water systems, and to provide water corporations with incentives to achieve economies that benefit ratepayers.

In order to implement SB 1268 and make any other necessary changes in our regulation of water company mergers and acquisitions, we asked all Class A water utilities, the California Water Association (CWA), the Commission Water Division and the Office of Ratepayer Advocates (ORA), and any other regulated water companies and interested parties to respond to the 10 specific questions. (Appendix C.) We granted the request of the City of San Jose that the comment period be extended to notify and also receive comments from all cities, counties and municipal water agencies in the state.

In response to our request for comments, five utilities and seven interested parties¹, including our Water Division and the ORA, filed written responses. The comments vary widely in response to our 10 questions. No hearings were requested or held in this proceeding. Frequent settlement meetings convened by Ratepayer Representation Branch (RRB) of the Water Division were held over a period of 10 months beginning April 6, 1998.

On February 2, 1999, RRB and CWA filed a joint motion to adopt a proposed settlement agreement. The proposed settlement agreement is sponsored by the following six of the remaining 11 parties: CWA (representing seven Class A and B water utilities), RRB, Dominguez Water Company, San Gabriel Water Company, Southern California Water Company, and Suburban Water Company. The signatory parties contend that the settlement agreement is in the public interest, meets all requirements of the Commission's Rule 51.1 regarding settlements, and should be approved. (Appendix D – Settlement Agreement.)

ORA and the City of San Jose (San Jose) filed comments on the proposed settlement agreement. They recommend that two terms of the agreement be modified, but do not oppose the agreement or request hearings thereon. CWA filed a timely reply to San Jose's comments stating that the requested modifications were unnecessary and redundant.

In summary, based upon the requirements of Rule 51.1, we conclude that the settlement agreement proposing regulations to be followed under the newly enacted Public Water System Investment and Consolidation Act is reasonable in light of the entire record, in the public interest and consistent with applicable

¹ See Appendix A.

law. We approve the settlement agreement and establish its terms as the guidelines for mergers and acquisitions of water utilities.

Background

In October 1996, at the Water Roundtable discussion of the water industry, several Commissioners expressed a keen interest in supporting a forum to discuss problems and recent changes in the water industry. Among the problems and changes then discussed were mergers and acquisitions. Subsequently, workshops on this subject were hosted by the Water Division in May 1997. The Commission sought to develop clear criteria to evaluate mergers and acquisitions as a basis for a formal rulemaking proceeding.

Two significant events also occurred at about the same time. SB 1268, the Public Water System Investment and Consolidation Act of 1997 was enacted and codified. (Pub. Util. Code §§ 2718, et seq.) In it, the Legislature declared that public water systems were faced with a need to improve their infrastructure to meet increasingly stringent state and federal safe drinking water laws and regulations governing fire flow standards for public fire protection. Thus, more capital to finance necessary investment in water systems would be needed. The Legislature believed that economies of scale were achievable in the operation of public water systems and desired to provide incentives for water corporations to seek these economies, which would benefit ratepayers. The incentive provided by SB 1268 was to allow fair market value as the standard to establish rate base where a distribution system is acquired. This standard replaced the former rate base standard of original cost less depreciation. In addition, if fair market value exceeds reproduction cost, the difference may be included in the new rate base provided the additional amount is found to be reasonable and will provide important benefits (Pub. Util. Code § 2720(b)).

The second significant event was the approval in the 1996 general election of Proposition 218, which may require an affirmative vote by the public before a public agency water system may raise property-related fees or taxes and arguably water rates. This new rule may cause municipally owned water systems to sell or lease to other municipal water systems, water districts or investor-owned water utilities. Thus, many more such systems may present opportunities to achieve economies of scale and financial and operational efficiencies, leading to the likelihood of acquisitions and mergers in this industry.

Accordingly, the Commission opened this proceeding to update regulations governing mergers and acquisitions.

Rulemaking Issues

In its order instituting rulemaking, the Commission asked respondent Class A and B utilities and interested parties to answer 10 questions. The parties' answers to these questions ranged from widely varying opinions on some to little dispute on others. A summary of the variance of responses to each question appears in Appendix D.

The proposed settlement agreement answers the 10 questions regarding what guidelines should be set to implement SB 1268, including who has the burden of proof, what the showing of the applicant shall be, and how evidence will be weighed. It also sets a schedule for the filing of applications for approval of a merger or acquisition and distinguishes this authority from Commission jurisdiction under Pub. Util. Code § 851, the sale of utility property.

Settlement Agreement

The proposed settlement agreement adopts fair market value as the rate base value of acquired systems, as specified in Pub. Util. Code § 2720. The agreement also contains terms to institute a predictable process of approval. Any

request for authorization to merge or acquire a Class A or B water utility will be preceded by a Notice of Intention (NOI). The NOI will include a showing indicating how the merger or acquisition would affect system reliability, compliance with health and safety regulations, economies of scale and rates to customers. The application pursuant to the NOI would be processed according to an agreed time schedule. If a utility must expedite improvements mandated by the Department of Health Services, the company may file an Advice Letter to approve the acquisition or merger. The Advice Letter is scheduled for completion in 100 days. An application requiring a hearing would take 245 days. The Advice Letter or application would be noticed to the public under existing customer notice requirements. In addition to an appraisal of the acquired system, the application or advice letter would include the proposed rates, a copy of the purchase agreement, service area map, notice to customers and service list. Any application would include a forecast of the results of operation for the acquiring utility, the acquired utility and the combined operation for the first and fifth years following acquisition, together with all supporting documentation. The following issues are also resolved in the agreement:

1. Long-term Financing

The parties agree that Pub. Util. Code §§ 852 and 854 do not require a privately owned utility to obtain authorization from the Commission before acquiring a publicly owned utility. However, each utility is required to file an application for approval of long-term financing involved in each acquisition.

2. Treatment of Government Loans

CWA and RRB agree that the cost of any plant or improvement funded by a federal or state government loan, which is not included in rate base, should *not* be included in the appraisal for ratesetting purposes. The acquiring

utility would be allowed to continue any surcharge established to repay any such loan until it is fully repaid.

3. Treatment of Contributed Facilities

CWA and RRB agree that any asset that is contributed without the requirement of compensation, that is a "contribution," should be valued in the appraisal in accordance with Evidence Code § 820.

4. Incentives

CWA and RRB agree that, for a period not to exceed seven years, a utility acquiring an inadequately operated and maintained utility should, pursuant to Decision (D.) 92-03-093, be permitted to exercise any one or a combination of the following options:

- a) Establish a memorandum account for expenses associated with unanticipated repairs;
- b) Design rates to recover up to 100% of fixed costs in the service charge;
- c) File for an increase in rates based on the most recent increase in the Consumer Price Index for All Urban Consumers; and,
- d) Set rates on the basis of the applicable rate or return on rate base permitted a Class C or Class D water utility.

Comments On The Proposed Settlement Agreement

Two parties, San Jose and ORA, commented on the proposed settlement agreement. Both criticized the proposed treatment of customer notice of proposed acquisitions or mergers. San Jose believes the proposed settlement should be modified to place in the customer notice the fifth-year impact. CWA replied that all costs are included in the first-year calculation of rates. Therefore, this modification would add no new information to the customer notice. It appears this modification is not needed.

ORA requests that the proposed settlement agreement treatment of the purchase price less than book value be reduced from book value plus 50% of book value to simply book value. ORA argues that book value treatment of the lesser purchase price is adequate incentive. We believe the proposed treatment is reasonable and serves the goals of SB 1268.

Discussion

The proposed settlement agreement is not sponsored by all parties in this proceeding. Therefore, the standard for review is that of Rule 51.1. In order to meet Commission approval, the proposed settlement agreement must be found to be reasonable in light of the entire record, serve the public interest and not contrary to applicable law.

Reasonable In Light Of The Entire Record

The record in this proceeding is the written comments and replies filed by 11 responding parties in the proceeding. Long Beach Water Department filed written comments but requested a status of "information only" instead of a party status in the proceeding. Southern California Edison did not file comments and changed its appearance as a party to the status of "information only" after a settlement was reached. While the parties often voiced opposing views on the issues presented, the agreement reflects compromise of these varying positions and resolves all issues in this proceeding. The agreement reflects consideration of these parties' interests, the interests of all other parties and those of ratepayers. The two parties filing comments on the agreement were those unable to participate in the 10-month period of discussion, negotiation and reaching a settlement. No party opposes the settlement and those who did not sign, other than San Jose and ORA, did not request modifications.

The agreement adopts fair market value for ratemaking purposes, which is required by Pub. Util. Code § 2720, and outlines a process and schedule for the timely review of any application to approve a merger or acquisition. The application process is clear, reasonable and accommodates expedited requests in order to address immediate service or quality problems ordered by DHS to be corrected. The standards set for approval of applications provide a method to assess whether the goals of SB 1268 are met, that is, whether a transaction achieves maximum economies of scale, provides quality system improvements or provides benefits to customers.

Therefore, the proposed settlement agreement is reasonable in light of the entire record in this proceeding.

Serves The Public Interest

The proposed settlement agreement seeks to implement SB 1268 in a manner that achieves its goals of providing incentives to purchase and acquire small, troubled water companies in a way that benefits the customer with better service and lower rates with adequate prior notice to the customer of the impact of a merger or acquisition. Therefore, the proposed settlement agreement is in the public interest.

Not Contrary To Applicable Law

We find no instance where the proposed settlement agreement contravenes applicable law. However, to insure that there is no confusion regarding the ratesetting authorization related to the acquisition of mutual or publicly-owned water systems, we shall clarify the process referenced in section 4.02 of the proposed settlement agreement. Section 4.02 of the settlement agreement provides:

"The Parties agree that the acquiring utility should be authorized to file an advice letter placing into effect the existing rates of its adjacent or nearby water system, the acquired system's rates, or rates lower than either."

Pursuant to section 451 of the Public Utilities Code, it is a distinct power and obligation of the Commission to establish just and reasonable rates for services or commodities rendered by a public utility. Accordingly, while utilities may file an advice letter requesting that rates be placed in effect for the acquired utility in the manner provided by section 4.02 of the proposed settlement agreement, the Commission may or may not find such proposed rates to be reasonable. Therefore, the reasonableness of the rates proposed should be addressed and justified in the advice letter. Furthermore, as anticipated by section 451 of the Public Utilities Code, the implementation of any rate for an acquired water system shall require individual action by the Commission authorizing said rates either through Commission resolution or decision.

Comments on Draft Decision

The draft decision of Administrative Law Judge Patricia Bennett in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g) and Rule 77.1 of the Rules of Practice and Procedure. No comments were filed.

Findings of Fact

1. On March 27, 1998, the RRB provided adequate notice to all parties of a settlement meeting on April 6, 1998. The CWA, representing seven regulated utilities, and RRB filed a joint motion to approve a proposed settlement agreement on February 2, 1999. The proposed settlement agreement is attached as Appendix D.
2. The proposed settlement agreement represents the interests of utilities and customers in merger and acquisition proceedings.

3. The proposed settlement agreement resolves all issues in this proceeding and sets the guidelines to implement SB 1268.

4. The proposed settlement agreement sets guidelines that meet the goals of the Legislature in SB 1268 and are reasonable.

5. The settlement conveys sufficient information to permit the Commission to discharge future regulatory obligations with respect to the parties and their interest.

6. The record contains the written comments of respondents and interested parties and the comments regarding the proposed settlement agreement.

Conclusions of Law

1. The proposed settlement agreement resolves all issues between all parties in this proceeding.

2. The proposed settlement agreement is reasonable in light of the entire record, is in the public interest and is not contrary to applicable law.

3. The motion to approve the settlement agreement should be granted.

4. In order to implement the agreed regulations as soon as possible under SB 1268, Pub. Util. Code §§ 2718, et seq., this order should be made effective immediately.

5. Section 451 of the Public Utilities Code provides a distinct power and obligation of the Commission to establish just and reasonable rates for services or commodities furnished by public utilities.

O R D E R

IT IS ORDERED that:

1. The motion to approve the settlement agreement attached as Appendix D is granted.

2. The rules set forth in Appendix D, as clarified by this decision with respect to the requirement that a Commission decision or resolution authorizing rates is a prerequisite to the implementation of rates for an acquired utility, are established as the operating procedures in accordance with Pub. Util. Code §§ 718, et seq., the Public Water System Investment and Consolidation Act of 1997, effective January 1, 1998.

3. A copy of the decision in this proceeding will be mailed to all parties in this proceeding and all Class A and B water utilities.

This order is effective today.

Dated October 21, 1999, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
JOEL Z. HYATT
CARL W. WOOD
Commissioners

APPENDIX A
LIST OF APPERANCES

APPENDIX A

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(END OF APPENDIX A)

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APPENDIX B

SENATE BILL 1268

APPENDIX B

CHAPTER 2.5. PUBLIC WATER SYSTEM INVESTMENT AND CONSOLIDATION
ACT OF 1997

(Chapter 2.5 added by Stats. 1997, Ch. 675, Sec. 1. Effective January 1, 1998.)

2718. This chapter shall be known and may be cited as the Public Water System Investment and Consolidation Act of 1997.

(Added by Stats. 1997, Ch. 675, Sec. 1. Effective January 1, 1998.)

2719. The Legislature finds and declares all of the following:

(a) Public water systems are faced with the need to replace or upgrade the public water system infrastructure to meet increasingly stringent state and federal safe drinking water laws and regulations governing fire flow standards for public fire protection.

(b) Increasing amounts of capital are required to finance the necessary investment in public water system infrastructure.

(c) Scale economies are achievable in the operation of public water systems.

(d) Providing water corporations with an incentive to achieve these scale economies will provide benefits to ratepayers.

(Added by Stats. 1997, Ch. 675, Sec. 1. Effective January 1, 1998.)

2720. (a) The commission shall use the standard of fair market value when establishing the rate base value for the distribution system of a public water system acquired by a water corporation. This standard shall be used for ratesetting.

(1) For purposes of this section, "public water system" shall have the same meaning as set forth in Section 116275 of the Health and Safety Code.

(2) For purposes of this section, "fair market value" shall have the same meaning as set forth in Section 1263.320 of the Code of Civil Procedure.

(b) If the fair market value exceeds reproduction cost, as determined in accordance with Section 820 of the Evidence Code, the commission may include the difference in the rate base for ratesetting purposes if it finds that the additional amounts are fair and reasonable. In determining whether the additional amounts are fair and reasonable the commission shall consider whether the acquisition of the public water system will improve water system reliability, whether the ability of the water system to comply with health and safety regulations is improved, whether the water corporation by acquiring the public water system can achieve efficiencies and economies of scale that would not otherwise be available, and whether the effect on existing customers of the water corporation and the acquired public water system is fair and reasonable.

(c) The provisions of subdivisions (a) and (b) shall also be applicable to the acquisition of a sewer system by any sewer system corporation or water corporation.

(d) Consistent with the provisions of this section, the commission shall retain all powers and responsibilities granted pursuant to Sections 851 and 852.

(Added by Stats. 1997, Ch. 675, Sec. 1. Effective January 1, 1998.)

(END OF APPENDIX B)

APPENDIX C

Responses to Rulemaking Issues

APPENDIX C Responses to Rulemaking Issues

1. What specific rules or guidelines, if any, should the Commission promulgate to implement SB 1268?

CWA points out that the language of SB 1268, with the crucial change codified in Pub. Util. Code § 2720, speaks for itself. It requires that the rate base value of an acquired company will be the amount of the fair market value and if the purchase price is greater than fair market value, the Commission will decide if any excess purchase price is fair and reasonable and should be collected in rates. However, CWA goes on to specify the types of rules and guidelines that are needed to achieve the goal of SB 1268 and provide incentives to purchase troubled companies. Other utilities agree that an acquiring utility must have a predictable, timely process with consistent regulatory standards to review applications so that it may make accurate business assessments of whether to bid for a small or "troubled" water system.

The City of San Jose voices a desire for public disclosure guidelines and accounting guidelines in spreading the cost of the return on rate base to the ratepayer, if any.

On the other hand, ORA interprets SB 1268 as read in conjunction with Pub. Util. Code § 851, the Commission's authority to approve or deny an application, as promoting only cost effective industry consolidation, not automatic approval of fair market value up to replacement cost, if this amount is not reasonable. ORA leans toward emphasizing the requirement that an acquisition must benefit ratepayers.

2. **Who should have the burden of proving whether the purchasing company made an arms's length transaction with the acquired company?**

CWA and San Gabriel do not believe SB 1268 addresses or requires such an assessment. They argue that if the purchase price is fair market value, or equal to or less than replacement cost less depreciation, the transaction is deemed reasonable and may be denied upon a showing that it is not reasonable.

Other utilities and ORA agree the purchasing company has the burden of showing the transaction is cost effective.

The City of San Jose believes the Commission should scrutinize a transaction for reasonableness since both the buyer and seller want the highest purchase price and if an acquiring company can spread the cost to adjacent districts, it may be able to offer a price higher than is reasonable in order to outbid other potential buyers.

3. **With the enactment of SB 1268, what showing will be necessary by the company to justify the purchase price? What showing will be necessary by the staff?**

CWA advocates no showing if the purchase price does not exceed reproduction cost less depreciation, that is, assume the price is the fair market value and no further inquiries unless a party provides evidence to refute this presumption. However, the utility would have the burden to show that any cost exceeding an appraisal is reasonable if it requests to place this amount in rate base. Other utilities contend the utility must show the sale results in economies of scale, serves the public interest and benefits the ratepayers of both the purchasing and selling companies.

ORA contends the utility must show that the acquisition results in lower rates, or improves service where rates will increase.

RRB advocates that the utility must present an appraisal showing the reasonableness of the price and show the benefit to ratepayers.

Parties agree that staff must carry the burden of proving any allegations it raises in any protest to the application.

4. **How should the Commission's jurisdiction over sale of a utility's property, as provided for in Section 851 of the Pub. Util. Code be administered? Could the Commission deny a sale if it would have an unreasonably adverse impact on either the selling or the buying company's ratepayers?**

Parties agree that enactment of SB1268 does not affect the Commission's jurisdiction or authority under Section 851. The Commission retains all such jurisdiction and authority, including the authority to deny approval of an acquisition or merger.

5. **Should the Commission provide any additional incentives to the purchasers of small, troubled water companies when taken over by a Class A, Class B, or a Class C?**

Parties answer either yes or no to this question. RRB believes existing incentives are adequate. Utilities agree that additional incentives are needed, especially increased earnings. As an added incentive, ORA would add the incentive of recording facilities at book value when the purchase price is lower than book value.

6. **Do the provisions of SB 1268 provide sufficient incentives to encourage the larger water companies to take over the smaller ones?**

Parties' answers vary from yes and no to "maybe". ORA believes using fair market value and book value when the purchase price is lower than book value is sufficient incentive. CWA recommends adopting the following five incentives where companies are "troubled": increased earnings; recover 100% of Class D and 65% of Class C fixed costs in the monthly service charge; memorandum accounts and automatic rate increase based on the annual consumer price index; new policies to improve financial stability, such as treating

Class C and D as 100% equity companies; and, authorizing acquired company's rate base even if purchase price is less than the rate base.

Penngrove and Kenwood Village (PKV) complain that staff proposes to do just the opposite of the intent of SB 1268 and reduce rates of return for Class D utilities where the combined number of connections in two or more *non-contiguous* utilities owned by a single owner exceeds 500 services because they consider them as a Class C utility. PKV sites this policy as a disincentive to purchasing a non-contiguous company.

7. How should the Commission, consistent with SB 1268 value the sale price for ratemaking if it is increased through competitive bidding?

There was a wide range of opinion on this issue. RRB and some utilities would allow the sales price in rates if the utility shows the sale results in improved reliability, improved compliance with water quality regulation or achievement of economies of scale for prices above reproduction cost less depreciation. Southern California Water (SoCal) would not allow in rates. ORA recommends a reasonableness test. Other utilities would set no special rules or assume that competition sets a price equal to the fair market value.

8. How should sales of utilities, water districts, and mutual water companies be treated for valuation of ratebase consistent with SB 1268?

Several utilities, CWA and ORA recommend using fair market value and not set different standards based upon the status of the acquired company. SoCal would review for "churning" abuse, that is selling above book value solely to increase rate base. SoCal believes this should only be allowed if it corrects past restrictions.

9. Should all sales and mergers conform to the Commission's uniform system of accounts for regulated water companies?

Parties would generally use the Commission's uniform system of accounts, but would revise them to reflect existing policy such as the rate base treatment of the purchase price required by SB 1268. City of San Jose points out that if municipalities acquired are required to revise all books and records, this increases the costs and possibly the purchase price of the company and should result in a specific public benefit if costs and rates are increased.

10. Are investor-owned water companies at a disadvantage when competing for the purchase of a private water company with a water district or municipality?

CWA and other utilities answer "yes" due to the limits and uncertainty of ratemaking policy and existing accounting treatment of sales. They also point out that public entities have greater access to tax-free capital, such as public bonds, standby charges, fees and taxes, pay no income or property taxes, have unfettered freedom to set rates and have no regulatory oversight. Therefore, CWA emphasizes the need in this proceeding to accept rules that permit utilities the flexibility of accomplishing mergers and acquisitions in a manner which makes good business sense and provides benefits to ratepayers, provides certainty of eligibility for favored ratemaking treatment, a system of timely effectiveness for new rates, incentives to engage in acquisitions.

City of San Jose points out the trend toward privatization of water systems and emphasizes that the Commission cannot artificially improve the competitive positions of investor-owned utilities and public agencies since both have its advantages and disadvantages. The important result to be achieved for the ratepayer is the lowest rate for a comparable product.

Dominguez Water Company (Dominguez) cites the outcome of its three recent purchases of small companies: minimal impact on rates and 4.5% increase

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in returns. Dominguez did not need to request any immediate rate change and will only need to do so after 1999. The smaller companies now have lower financing costs under Dominguez' Class A the equity structure.

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APPENDIX D

SETTLEMENT AGREEMENT

APPENDIX D

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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's)
 own motion to set rules and provide guidelines for) R.97-10-048
 the Acquisition and Mergers of Water Companies)
 _____)

SETTLEMENT

1.00 Introduction

1.01 The parties to this Settlement ("Parties") relating to the Order Instituting Rulemaking issued by the California Public Utilities Commission ("Commission") on October 22, 1997, are the Ratepayers Representation Branch ("RRB") of the Water Division and the California Water Association ("CWA").

1.02 The Parties agree that no signatory hereto nor any member of the staff of the Commission assumes any personal liability as a result of this Settlement. The Parties agree that no legal action may be brought in any state or federal court, or in any other forum, against any signatory representing the interests of RRB, any individual of RRB, its attorneys, or the RRB itself regarding this Settlement. All rights and remedies are limited to those available before the Commission.

2.00 General Requirements Regarding Acquisitions and Mergers of Public Utilities

2.01 Definition of Acquisition. An "acquisition" is a merger, a purchase of stock or assets, or an exchange of stock.

2.02 Notice Of Intention. The Parties agree that any request for authorization to acquire a Class A or B water utility should be preceded by a Notice of Intention. Such notice should include a showing as to how the merger or acquisition would affect reliability, compliance with regulations relating to health and safety, economies of scale, and customers.

2.03 Processing. The Parties agree that applications should be processed according to the schedules attached to this Settlement.

2.04 Results of Operations. The Parties agree that each application should include a forecast of the results of operation for (1) the acquiring utility, (2) the acquired utility, and (3) the combined operation for the first and fifth years following acquisition, together with all supporting documentation.

2.05 Appraisal. The Parties agree that the filing of each application should include an appraisal, together with all supporting materials and workpapers. The appraisal should include all assets, including the value of the land and the cost of replacing the existing improvements, less accumulated depreciation. The complexity and detail required will necessarily vary based on the size and price of the acquired water system.

2.06 Facilities Funded by the Federal or State Government. The Parties agree that the cost of any plant or improvement of a privately-owned utility which is funded by a loan from the federal or state government and not included in rate base should not be included in the appraisal for the purpose of setting rates. The acquiring utility should be allowed to continue any surcharge established to repay any such loan until fully repaid.

2.07 Assets Funded by Contributions. The Parties agree that any asset funded by contribution should be valued in the appraisal in accordance with Section 820 of the Evidence Code.

3.00 Acquisition of Inadequately Operated and Maintained Small Water Utilities

3.01 Definition of Inadequately Operated and Maintained Small Water Utility. An "inadequately operated and maintained small water utility" is any operation serving under 2,000 customers that is subject to an outstanding order of the Department of Health Services to implement improvement.

3.02 Use of Advice Letter. To expedite improvements mandated by the Department of Health Services, the transfer of assets and related obligations of an inadequately operated and maintained small water utility may be approved by the Commission pursuant to an advice letter.

3.03 Incentives. The Parties agree that, for a period not to exceed seven years, a utility acquiring an inadequately operated and maintained utility should, pursuant to D.92-03-093, be permitted to exercise any one or combination of the following options:

- A. Establish a memorandum account for expenses associated with unanticipated repairs,
- B. Design rates to recover up to 100% of fixed costs in the service charge,
- C. File for an increase in rates based on the most recent increase in the Consumer Price Index for All Urban Consumers, and
- D. Set rates on the basis of the applicable rate of return on rate base permitted a Class C or a Class D water utility.

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3.04 Premium Above Purchase Price. The Parties agree that, if the purchase price is less than book value, the acquiring utility should be authorized to earn a return on the price paid plus 50 percent of the difference between book value and the price paid. The amount above the purchase price should be amortized over the average remaining life of the plant. In addition, the price paid shall include for purposes of ratemaking any cost incurred to complete the acquisition.

4.00 Acquisition of Mutual and Publicly-Owned Water Systems

4.01 Sections 852 and 854 of the Public Utilities Code. The Parties agree that neither Section 852 nor Section 854 of the Public Utilities Code requires a privately-owned utility to obtain authorization from the Commission before acquiring a publicly-owned utility.

4.02 Filing of Rates. The Parties agree that the acquiring utility should be authorized to file an advice letter placing into effect the existing rates of its adjacent or nearby water system, the acquired system's rates, or rates lower than either.

4.03 Notice. Notice of a proposed acquisition should be given to all affected customers at the time when any advice letter or application is filed with the Commission. Additionally, the notice should contain a comparison of the rates before the acquisition and for the first year after the acquisition and identify any cost, including a reasonable return, not fully reflected in the first year's rates. With respect to the acquisition of a water system of a municipality, similar notice should be given to all affected customers prior to any election.

5.00 Financing Subject to Approval by the Commission. The Parties agree that each utility is required to file an application for approval of long-term financing involved in each acquisition. An example of long-term financing is a municipality that agrees to sell its water system in exchange for annual payments from the acquiring utility. The Parties further agree that a utility may either file an application for the long-term financing of a particular acquisition or rely on authorization previously given by the Commission for long-term financing.

ACQUISITION OF A CLASS A OR B WATER UTILITY

DAY	EVENT
- 40	Notice of Intention
- 20	Notice of Deficiency
0	Application filed
20	Utility notified by RRB whether it will request an independent appraisal (excludes municipal corporations)
30*	Prehearing Conference
80	RRB's Report
115-125	Hearings
155	Briefs
215**	Proposed Decision
245***	Commission's Agenda

* Scheduled dates after the prehearing conference assume no independent appraisal.

** Or 60 days after the case is submitted.

*** Or 90 days after the case is submitted.

APPENDIX D

Page 5

ACQUISITION OF A CLASS C OR D WATER UTILITY

DAY	EVENT
0	Application filed
30	Notice of Deficiency
45	Prehearing Conference
90	RRB's Report
120-125	Hearings
155	Briefs
215*	Proposed Decision
245**	Commission's Agenda

REQUIREMENTS FOR APPLICATIONS AND ADVICE LETTERS

In addition to an appraisal, a filing must include the following:

- Proposed Rates
- Copy of Purchase Agreement
- Service Area Map
- (mutual and governmental acquisitions only)
- Copy of Notice to Customers
- Service List, including Expected Increased Parties
- (such as wholesale suppliers and adjacent utilities)

* Or 60 days after the case is submitted.

** Or 90 days after the case is submitted.

ADVICE LETTER

DAY	EVENT
0	Advice Letter Filed
30	Notice of Deficiency
40*	Utility's Response
70**	Draft Resolution
100**	Commission's Agenda

* Assumes that utility fully responds to deficiency letter within 10 days. (If complete response not received by Day 40, the schedule will be adjusted accordingly.)

** If Commission approval is required.

REQUIREMENTS FOR APPLICATIONS AND ADVICE LETTERS

In addition to an appraisal, a filing must include the following:

- Proposed Rates
- Copy of Purchase Agreement
- Service Area Map
(mutual and governmental acquisitions only)
- Copy of Notice to Customers
- Service List, Including Expected Interested Parties
(such as wholesale suppliers and adjacent utilities)

Respectfully submitted,

Program Manager, Ratepayer
Representation Branch of the
Water Division

February 2, 1999



Vice President, Regulatory Affairs
California Water Service Company

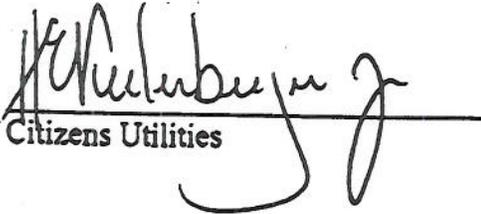
February 2, 1999

Respectfully submitted,


California American Water

February 2, 1999

Respectfully submitted,


Citizens Utilities

February 2, 1999

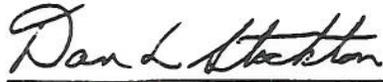
Respectfully submitted,



Dominguez Water Corporation
V.P. Finance

February 2, 1999

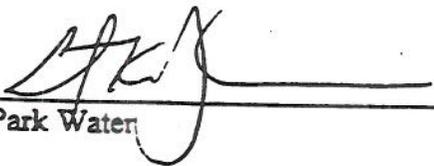
Respectfully submitted,



Great Oaks Water Company

February 2, 1999

Respectfully submitted,



Park Water

February 2, 1999

Respectfully submitted,

SAN GABRIEL VALLEY WATER COMPANY

By: 
Michael L. Whitehead

Title: President

Date: February 2, 1999

Respectfully submitted,



San Jose Water Company

February 2, 1999

Respectfully submitted,

Respectfully submitted,

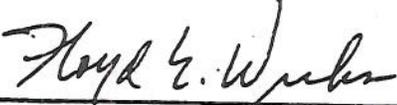


Santa Clarita Water Company
John Garon
U.P./CFO
February 2, 1999



Southern California Water Company
February 2, 1999

Respectfully submitted,



Southern California Water Company

February 2, 1999

Respectfully submitted,

Respectfully submitted,



Suburban Water Systems

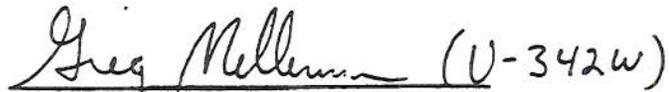


Suburban Water Systems

February 2, 1999

February 2, 1999

Respectfully submitted,


Valencia Water Company

February 2, 1999

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document entitled **SETTLEMENT** upon all known parties of record by mailing, by first-class mail, a copy thereof properly addressed to each party.

Dated at San Francisco, California, this 2nd day of February, 1999.

/s/ BERLINA GEE

Berlina Gee

(END OF APPENDIX D)