



STATE OF CALIFORNIA

GAVIN NEWSOM, Governor **FILED**

PUBLIC UTILITIES COMMISSION

08/10/22

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

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A1809013

August 10, 2022

Agenda ID #20878
Ratesetting

TO PARTIES OF RECORD IN APPLICATION 18-09-013:

This is the proposed decision of Administrative Law Judge Peter Wercinski. Until and unless the Commission hears the item and votes to approve it, the proposed decision has no legal effect. This item may be heard, at the earliest, at the Commission's September 15, 2022 Business Meeting. To confirm when the item will be heard, please see the Business Meeting agenda, which is posted on the Commission's website 10 days before each Business Meeting.

Parties to the proceeding may file comments on the proposed decision as provided in Rule 14.3 of the Commission's Rules of Practice and Procedure.

The Commission may hold a Ratesetting Deliberative Meeting to consider this item in closed session in advance of the Business Meeting at which the item will be heard. In such event, notice of the Ratesetting Deliberative Meeting will appear in the Daily Calendar, which is posted on the Commission's website. If a Ratesetting Deliberative Meeting is scheduled, *ex parte* communications are prohibited pursuant to Rule 8.2(c)(4).

/s/ ANNE E. SIMON

Anne E. Simon
Chief Administrative Law Judge

AES:lii

Attachment

Decision **PROPOSED DECISION OF ALJ WERCINSKI** (Mailed 8/10/2022)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application for Order Authorizing
California-American Water Company
(U210W) to Purchase Bellflower
Municipal Water System's Assets and
for Related Approvals.

Application 18-09-013

**DECISION APPROVING CALIFORNIA-AMERICAN WATER COMPANY'S
ACQUISITION OF BELLFLOWER MUNICIPAL WATER SYSTEM**

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Attachment 1 - Settlement Agreement

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**DECISION APPROVING CALIFORNIA-AMERICAN WATER COMPANY'S
ACQUISITION OF BELLFLOWER MUNICIPAL WATER SYSTEM**

Summary

We approve the amended application of California-American Water Company (Cal-Am) for an order authorizing Cal-Am's acquisition (Acquisition) from the City of Bellflower (Bellflower) of the assets of the Bellflower Municipal Water System (Bellflower MWS), and we grant the joint motion of Cal-Am and the Public Advocates Office for adoption of their settlement agreement (Settlement Agreement), which incorporates Cal-Am's amended application and the November 27, 2017 asset purchase agreement between Cal-Am and Bellflower. The Settlement Agreement, which provides for a purchase price of \$17 million and reflects Bellflower's November 1, 2021 infrastructure agreement (Infrastructure Agreement) commitment to make \$5 million in grant funding available to Cal-Am by the close of the Acquisition for post-Acquisition capital improvements to the Bellflower MWS, is reasonable in light of the whole record, consistent with law, and in the public interest. Effective at the close of the Acquisition, Cal-Am's rate base will increase by \$17 million to reflect the \$17 million fair market value of the assets of the Bellflower MWS and will be reduced by \$5 million as a result of the accounting treatment of Bellflower's \$5 million grant as a contribution to Cal-Am. As a result of these two rate base adjustments, Cal-Am's rate base will increase by \$12 million effective at the close of the Acquisition.

This proceeding is closed.

1. Background

The Bellflower Municipal Water System (Bellflower MWS) is located in Bellflower, California in southeast Los Angeles County and provides water service to about 1,826 customers in seven non-contiguous service

areas. The Bellflower MWS consists of water supply sources and a water delivery system that interconnects with a neighboring water system and includes one active well, three standby wells, three storage tanks, water pipelines, fire hydrants, isolation valves, blow-off valves, and six interconnections.¹

On November 27, 2017, California-American Water Company (Cal-Am) and the City of Bellflower (Bellflower) entered into an Asset Purchase Agreement for Cal-Am to purchase the assets of the Bellflower MWS from Bellflower for \$17 million (the Acquisition). The Acquisition includes Cal-Am's purchase of 700 acre-feet of Central Basin Annual Pumping Allocation water rights.²

On September 14, 2018, Cal-Am filed its Application with the California Public Utilities Commission (Commission) for approval of the Acquisition. On October 29, 2018, the Public Advocates Office (Cal Advocates) filed its protest to the Application. Cal-Am filed a reply on November 8, 2018. On November 20, 2018, Bellflower filed a motion for party status. A prehearing conference was held on January 7, 2019, at which time Bellflower's motion for party status was granted.

On January 22, 2019, Cal-Am filed an amended application (Amended Application) requesting Commission approval of the Acquisition. On April 12, 2019, the assigned Commissioner issued the Scoping Memo and Ruling (Scoping Memo). A public participation hearing was held on May 29, 2019, and evidentiary hearings were held

¹ Exhibit Cal-Am 19 Attachment 4 at 1.

² *Id.* at 4, Attachment 1 at 1.

on June 5-6, 2019. At the evidentiary hearings, Exhibits Cal-Am 1, Cal-Am 3 through Cal-Am 18, Cal-PA 1, Cal-PA 01-A, Cal-PA 2 through Cal-PA 6, Cal-PA 8, and Cal-PA 9 were admitted into evidence. Cal-Am, Cal Advocates, and Bellflower filed opening briefs on July 12, 2019 and reply briefs on July 31, 2019.

On March 30, 2020, the assigned Administrative Law Judge (ALJ) issued a proposed decision (PD) denying Cal-Am's application. Cal-Am and Bellflower filed comments on the PD on June 19, 2020. Cal Advocates filed reply comments on the PD on July 3, 2020. On July 8, 2020, Cal-Am filed a motion to reopen the evidentiary record. On July 15, 2020, Cal Advocates filed a response to Cal-Am's motion to reopen the evidentiary record, and Cal-Am filed a reply regarding that motion on July 23, 2020. On August 5, 2020, an ALJ ruling granted Cal-Am's motion to open the evidentiary record to take additional evidence regarding the value of the Bellflower MWS and ordered the parties to engage in settlement negotiations. The PD was withdrawn at the Commission's August 6, 2020 meeting.

On March 18, 2021, an ALJ ruling ordered the preparation of a new valuation of the Bellflower MWS and the service of a valuation report, ordered the parties to discuss settlement, and directed that the valuation report be admitted into evidence. In response to the March 18, 2021 ALJ ruling, Cal-Am submitted the valuation report (2021 Valuation Report) that can be found at <https://docs.cpuc.ca.gov/PublishedDocs/SupDoc/A1809013/3908/394802069.pdf> as of the date of this decision and that is admitted into evidence as Exhibit Cal-Am 19.

On November 1, 2021, Cal-Am and Bellflower entered into an Agreement Regarding Water Infrastructure Improvement Funding (Infrastructure

Agreement). On November 23, 2021, Cal-Am and Cal Advocates entered into a settlement agreement (Settlement Agreement) attached to this decision as Attachment 1 and filed a Joint Motion for Adoption of Settlement Agreement (Motion). A November 23, 2021 letter on behalf of Bellflower stated that Bellflower does not oppose the Settlement Agreement or its approval by the Commission. On December 21, 2021, an ALJ ruling required Cal-Am to provide responses to matters regarding the Settlement Agreement. On January 18, 2022, Cal-Am filed responses to the December 21, 2021 ALJ ruling and requested that those responses be admitted into evidence as Exhibit Cal-Am 20. On February 4, 2022, an ALJ ruling required Cal-Am and Cal Advocates to provide additional responses to matters regarding the Settlement Agreement. On February 28, 2022, Cal-Am and Cal Advocates filed responses to the February 4, 2022 ALJ ruling, and Cal-Am requested that its responses be admitted into evidence as Exhibit Cal-Am 21.

2. Issues Before the Commission

The Scoping Memo identifies the following issues to be determined in this proceeding:

1. Whether the Acquisition should be approved and, if so, whether it should be approved with conditions;
2. Whether the Acquisition benefits both Cal-Am's and Bellflower MWS's customers;
3. If the Acquisition is approved, whether and how the Bellflower MWS will be consolidated with Cal-Am's existing service area for operational and/or ratemaking purposes;
4. If the Acquisition is approved, whether the Commission should approve Cal-Am's request to track the costs of addressing any required environmental improvements and compliance issues in Cal-Am's existing memorandum

- account 2 for the Dunnigan, Geyserville and Meadowbrook purchases;
5. If the Acquisition is approved, whether the Commission should approve Cal-Am's request to establish a new memorandum account to track the costs associated with the Acquisition and whether tracked costs should be included in rate base or treated as expenses to be considered for recovery in a subsequent Cal-Am general rate case (GRC) proceeding;
 6. If this proceeding is not resolved by the time Cal-Am files its application for its 2019 GRC, should the Commission allow Cal-Am to create a "contingency" memorandum account to capture the difference in revenue between the current rates and final rates if the Acquisition is approved;
 7. Whether Cal-Am's Replacement Cost New Less Depreciation (RCNLD) valuation is accurate and reasonable and whether the results of the RCNLD valuation represent Bellflower MWS's reproduction cost consistent with the requirements of Public Utilities (Pub. Util.) Code Section 2720;
 8. Whether the Bellflower MWS is in violation of any health or safety requirements;
 9. Whether the Bellflower MWS qualifies as an Inadequately Operated and Maintained Small Water Utility and, if so, whether the distressed incentives of Decision (D.) 99-10-064 should apply;
 10. Whether Code of Civil Procedure (CCP) Section 1263.320(a) or Section 1263.320(b) should be used to determine the fair market value (FMV) of a public utility;
 11. Whether reliance on the FMV of the acquired company's entire public water system should be used as opposed to the FMV of only its distribution system to set the rate base or be treated as expenses to be considered for recovery in a subsequent GRC;
 12. If the Acquisition is approved, whether the full purchase price (\$17 million) paid by Cal-Am is the FMV and, if so,

- whether the Commission should establish the rate base for the Bellflower MWS as less than or equal to this FMV;
13. If the Acquisition is approved, whether the Bellflower MWS should be relieved of its public utility obligations following the close of the sale or when Cal-Am has obtained all applicable permits to operate the Bellflower MWS; and
 14. Whether Cal-Am's customers have been properly noticed in accordance with the requirements of Rules 3.2 and 3.6 of the Commission's Rules of Practice and Procedure (Rule or Rules).

In addition, we address in Section 3.11 below whether Commission review under the California Environmental Quality Act (CEQA) is required for approval of the Amended Application; we address in Section 3.12 below whether the Commission should approve the October 20, 2017 Agreement for Transmission and Production of Water (Wheeling Agreement) between Cal-Am and Bellflower-Somerset Mutual Water Company (Bellflower-Somerset) attached to this decision as Attachment 2; and we address in Section 3.13 below whether the Commission should approve a modification of Cal-Am's Certificate of Public Convenience and Necessity to include the service territory of the Bellflower MWS.

3. Discussion

3.1. Joint Motion for Adoption of Settlement Agreement

Cal-Am and Cal Advocates have filed the Motion for Adoption of Settlement Agreement. Under Rule 12.1(d), the Commission will not approve a settlement unless it is reasonable in light of the whole record, consistent with law, and in the public interest. California has a strong public policy favoring settlements because they reduce litigation expenses, conserve scarce resources of parties and the Commission, and allow parties to reduce the risk that litigation

will produce unacceptable results.³ Settlements benefit the Commission, the parties, and the public at large by reducing the amount of Commission time and resources dedicated to the proceeding, thereby allowing the Commission to focus on other matters. Settlement can also serve as a model for earlier resolution of other proceedings by demonstrating the tangible benefits of effective communication and a practical mindset.⁴

3.1.1. Reasonableness in Light of Whole Record

We first address whether the financial terms of the Settlement Agreement are reasonable in light of the whole record. Paragraph 7.1(b) of the Settlement Agreement provides that the settling parties Cal-Am and Cal Advocates have agreed to and request Commission approval for the same \$17 million purchase price reflected in the Asset Purchase Agreement and the Amended Application. Before the Settlement Agreement, Cal-Am and Cal Advocates had vigorously disputed whether the Commission should approve the Acquisition given the \$17 million purchase price. Cal-Am provided a 2017 appraisal reflecting a total RCNLD valuation of the Bellflower MWS of \$20,945,831.⁵ Cal Advocates, to the contrary, asserted that the \$17 million purchase price was “unreasonable” and “inflated”⁶ and that Cal-Am’s \$20,945,831 appraisal valuation was an “artifice” that “contains multiple deficiencies, flaws, and inconsistencies.”⁷ In particular, Cal Advocates cited to the evidentiary record and argued that Cal-Am’s

³ D.05-11-005 at 16.

⁴ D.21-04-008 at 61.

⁵ Exhibit Cal-Am 6 at 6, Attachment 1 at 3.

⁶ July 12, 2019 Cal Advocates Opening Brief (Cal Advocates Opening Brief) at 4.

⁷ *Id.* at 5.

valuation had underestimated the accrued physical depreciation of the Bellflower MWS,⁸ had failed to take functional obsolescence into account,⁹ and had failed to consider necessary safety upgrades.¹⁰

In response to the March 18, 2021 ALJ ruling, Cal-Am submitted the 2021 Valuation Report that estimates the value of the 700 acre-feet of water rights to be acquired by Cal-Am in the Acquisition and provides a new total RCNLD valuation of the Bellflower MWS.¹¹ The 2021 Valuation Report contains detailed descriptions of the methodologies employed to produce the identified valuations and the backgrounds of the persons and entities involved in its preparation. Cal Advocates did not contest the conclusions or methodologies used in the 2021 Valuation Report, and we find that the conclusions reached in the 2021 Valuation Report are well-supported and credible.

Based upon recent sales, the June 17, 2021 WestWater Research Memorandum (WestWater Memorandum) included in the 2021 Valuation Report estimates that the value of the 700 acre-feet of water rights that Cal-Am would acquire in the Acquisition is between \$9,450,000 and \$10,465,000.¹² In addition, the July 14, 2021 Brown and Caldwell Technical Memorandum (Brown and Caldwell Memorandum) included in the 2021 Valuation Report places a total replacement cost before depreciation of the Bellflower MWS (inclusive of real property, including easements, but exclusive of the value of water rights) at

⁸ Exhibit Cal-PA 1 at 14; Cal Advocates Opening Brief at 6.

⁹ Exhibit Cal-PA 1A at 2-10, Attachment 2-2; Cal Advocates Opening Brief at 6-8.

¹⁰ Exhibit Cal-PA 1A at 3-254 to 3-257, Attachment 3-13; Cal Advocates Opening Brief at 8-9.

¹¹ Exhibit Cal-Am 19 at 4, Attachments 1-4.

¹² *Id.* Attachment 1 at 6.

\$27,593,266 and a RCNLD valuation of \$10,257,687.¹³ As a result, the WestWater Memorandum and the Brown and Caldwell Memorandum reflect a collective valuation of water rights and RCNLD property in the range of \$19,707,687 to \$20,722,687.

The 2021 Valuation Report also includes a July 16, 2021 Willamette Management Associates appraisal (Willamette Appraisal) of the Bellflower MWS that relies in part on the WestWater Memorandum and the Brown and Caldwell Memorandum. Unlike earlier Cal-Am appraisals, however, the Willamette Appraisal also considers all forms of depreciation, including physical deterioration, functional obsolescence, and economic obsolescence. The Willamette Appraisal values Bellflower MWS's RCNLD tangible property assets at \$7,693,000, assessed real estate at \$979,000, and water rights covered by the Acquisition at \$9,958,000, resulting in a total RCNLD valuation of the Bellflower MWS assets to be sold to Cal-Am of \$18.6 million.¹⁴

The valuations described above reflect a total RCNLD valuation of the Bellflower MWS assets to be acquired by Cal-Am in a range of \$18.6 million to \$20.7 million. We find the \$17 million purchase price to be reasonable in light of the valuation range for the Bellflower MWS reflected in the 2021 Valuation Report.

Paragraph 7.1(d) of the Settlement Agreement contains a significant new financial term benefitting Cal-Am that was not a part of the Asset and Purchase Agreement or the Amended Application: Bellflower's commitment in the Infrastructure Agreement to make \$5 million available to Cal-Am by the close of

¹³ *Id.* Attachment 2 at 6, Attachment 3 at 2.

¹⁴ *Id.* Attachment 4 at 4.

the Acquisition for capital improvements to the Bellflower MWS. The Infrastructure Agreement provides that (1) Bellflower will establish a trust fund into which it will deposit \$5 million on or before the close of the Acquisition, (2) Cal-Am will submit applications for funding of infrastructure improvements to a technical advisory committee (TAC) composed of Cal-Am and Bellflower representatives, (3) Cal-Am may seek payment for infrastructure improvements either in a lump sum or by progress payments, (4) trust funds must be obligated by the TAC to a project by December 31, 2024 or they will revert to Bellflower, and (5) the trust fund will expire on December 31, 2026, with unexpended funds at that date reverting to Bellflower.¹⁵ In the Infrastructure Agreement, Bellflower represents that (1) Bellflower has received \$5 million in funds pursuant to the American Rescue Plan Act of 2021 for potable water infrastructure projects, (2) Cal-Am is a proper recipient of those funds, and (3) Cal-Am may use the funds for Bellflower MWS infrastructure improvement projects.¹⁶

Bellflower's new \$5 million commitment to Cal-Am addresses Cal Advocates' earlier concerns that Cal-Am's valuation had failed to recognize the sizable future capital investment needed to rectify Bellflower MWS's deteriorating and obsolete capital infrastructure. A Condition-Based Assessment of the Bellflower MWS prepared for Cal-Am and included in the 2021 Valuation Report estimates a cost of \$10,675,000 over 20 years for a main replacement program, with about \$9,458,000 of that amount planned within the first 10 years.¹⁷ Cal-Am has proposed a capital improvements schedule using funds from Bellflower's \$5 million commitment of \$800,000 in 2022 and \$4,200,000

¹⁵ Exhibit Cal-Am 20 Attachment A at 6-7, Attachment 2-1 at 2-5.

¹⁶ *Id.* Attachment A at 6, Attachment 2-1 at 5-6.

¹⁷ Exhibit Cal-Am 19 at 9, Attachment 7 at 5.

in 2023 and funds from Cal-Am itself of \$1,000,000 in 2024, \$1,035,000 in 2025, \$1,071,225 in 2026, and \$1,108,718 in 2027.¹⁸ We find that Cal-Am's capital improvements plan, including its use of Bellflower's \$5 million commitment, reasonably addresses the 2021 Valuation Report's estimated infrastructure costs for the Bellflower MWS.

After full consideration of the evidentiary record, particularly the 2021 Valuation Report that is the most recent and most inclusive valuation of the Bellflower MWS, we find that the Settlement Agreement's \$17 million purchase price, coupled with Bellflower's \$5 million capital improvements commitment, reflects a reasonable and well-supported compromise of the parties' positions. Therefore, we find the financial terms of the Settlement Agreement to be reasonable in light of the whole record.

Sections 1 through 6 and 8 through 13 of the Settlement Agreement contain provisions that are not reasonably subject to dispute, and we do not find any reason to disapprove them. The provisions of Section 7 of the Settlement Agreement are either addressed elsewhere in this decision or are routinely approved by the Commission in other proceedings. Therefore, we find that the Settlement Agreement is reasonable in light of the whole record.

3.1.2. Consistency with Law

In D.99-10-064 as part of the landmark rulemaking proceeding Rulemaking 97-10-048, the Commission established guidelines for acquisitions of water companies, including the requirement to file an appraisal covering the value of all assets, including the value of the land and the cost of replacing the

¹⁸ Exhibit Cal-Am 20 Attachment A at 4.

existing improvements less accumulated depreciation.¹⁹ As described in Section 3.1.1 above, Cal-Am filed the 2021 Valuation Report that reflects an RCNLD valuation of the assets of the Bellflower MWS in a range of \$18.6 million to \$20.7 million. Therefore, we find that Cal-Am has complied with the appraisal requirements of D.99-10-064.

We have reviewed all provisions of the Settlement Agreement and conclude that no provision violates or is inconsistent with any law, rule, order, or decision of the Commission. Therefore, we find that the Settlement Agreement is consistent with law.

3.1.3. Public Interest

Under Rule 12.1(d), Commission approval of a settlement agreement requires the finding that the settlement agreement is in the public interest. The Public Water System Investment and Consolidation Act of 1997, codified at Pub. Util. Code § 2719, reflects the following findings of the California Legislature regarding the public interest factors relevant to the acquisition of a public water system by a water corporation:

- (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.

¹⁹ D.99-10-064 Appendix D Section 2.05.

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

Cal-Am's size, resources, and experience result in it being favorably positioned to provide safe, reliable water to the customers previously served by Bellflower MWS. Cal-Am is one of the largest investor-owned water utilities in California and is a subsidiary of American Water Works Company, Inc., the largest publicly traded water and wastewater utility in the United States. Further, Cal-Am's breadth of experience and resources makes it more likely to improve the level of service now provided to Bellflower MWS customers.²⁰ Cal-Am's statewide asset footprint, with its large customer base, also increases the likelihood that it will address Bellflower MWS's operational and financial challenges by leveraging its size to implement economies of scale to spread costs across a broader spectrum of customers.²¹ As a subsidiary of a national, publicly traded water utility, Cal-Am benefits from national bulk pricing contracts, resulting in economies of scale regarding chemical and other quantity-related purchases.²² In addition, Cal-Am's experience will enable it to respond to environmental and other regulatory requirements and implement safety programs for the protection of employees and customers.²³ As Cal-Am noted in its testimony, it has had substantial recent experience in taking over the operation of smaller systems and improving safety and service quality.²⁴

²⁰ Exhibit Cal-Am 3 at 19.

²¹ *Id.* at 4, 21.

²² Exhibit Cal-Am 1 at 7.

²³ Exhibit Cal-Am 3 at 4-5; Exhibit Cal-Am 1 at 4.

²⁴ Exhibit Cal-Am 1 at 4-5.

In determining whether the Settlement Agreement is in the public interest, we also consider its impact on customer bills. Cal-Am has provided estimated residential customer bill impacts for the period from 2022 through 2027 that reflect the dual effects of the Acquisition purchase price and post-Acquisition capital improvements. Cal-Am's bill estimates are generally consistent with the ratemaking implementation incorporated into the settlement agreement adopted by the Commission in D.21-11-018 in the GRC proceeding Application (A.) 19-07-004.²⁵ The following table shows Cal-Am's estimated percentage increase in average monthly residential customer bills resulting from the Settlement Agreement by service area and year.

Service Area	2022	2023	2024	2025	2026	2027
Sacramento	0.5%	None	None	None	None	None
Los Angeles-Baldwin Hills	0.3%	0.3%	0.3%	0.1%	0.1%	0.1%
San Diego	0.2%	0.2%	0.2%	0.1%	0.1%	0.1%
Bellflower	3.3%	0.3%	0.3%	0.1%	0.1%	0.1%

²⁵ That decision authorized Cal-Am to normalize the rate base of three Cal-Am acquisitions to spread the adjustments resulting from the acquisitions statewide. In A.19-07-004, Cal-Am requested the Commission to partially normalize the Bellflower MWS acquisition adjustment. However, because this proceeding was still pending when D.21-11-018 was issued, that decision did not implement a Bellflower MWS acquisition adjustment. The table in this section showing estimated impacts of the Settlement Agreement on average residential customer bills by service area reflects the Bellflower MWS normalization proposed by Cal-Am in A.19-07-004. In addition, the table reflects rate implementation commencing in 2022 rather than the GRC test year of 2021, and a \$5 million reduction to rate base from the Bellflower Infrastructure Agreement grant. Exhibit Cal-Am 20 Attachment A at 3-4. The rate base reduction resulting from Bellflower's \$5 million Infrastructure Agreement commitment is discussed in detail in Section 3.3 below.

On balance, we find these estimated impacts to average residential customer bills to be moderate and commensurate with the expected public interest benefits in reliability, safety, and service resulting from Cal-Am's Acquisition.

In addition to the above-described public interest considerations, the Commission's 2010 Water Action Plan sets forth public interest objectives regarding water quality, conservation, infrastructure investment, and low-income ratepayer assistance. The evidence reflects that the Acquisition will further those objectives.²⁶

After review of the public interest considerations described above, we find that the Settlement Agreement is in the public interest. The Settlement Agreement satisfies the required criteria of Rule 12.1(d) because it is reasonable in light of the whole record, consistent with law, and in the public interest. Therefore, we grant the Motion of Cal-Am and Cal Advocates to adopt the Settlement Agreement.

3.2. FMV and Rate Base of Bellflower MWS

The Commission shall use the standard of FMV when establishing the rate base value for the distribution system of a public water system acquired by a water corporation.²⁷ FMV is the highest price on the date of valuation that would be agreed to by a willing seller and a willing buyer, each under no particular necessity to do so and dealing with each other with full knowledge of all uses and purposes for which the property is reasonably adaptable and available.²⁸ The FMV of property for which there is no comparable, relevant market is its value

²⁶ Exhibit Cal-Am 3 at 22-25.

²⁷ Pub. Util. Code § 2720(a).

²⁸ CCP § 1263.320(a).

on the date of valuation as determined by any method of valuation that is just and equitable.²⁹ The standard of FMV shall be used for ratesetting.³⁰

In the Amended Application, Cal-Am requests that the Commission authorize rate base equal to the total purchase price of \$17 million.³¹ Cal Advocates, which had previously argued against that request, has now entered into the Settlement Agreement with Cal-Am in which Paragraph 7.1(c) requests that the entire \$17 million purchase price be used as the rate base of the assets of the Bellflower MWS.³²

In determining FMV, we reject any notion that a contractual purchase price is always the FMV of property without further inquiry. In this case, however, (1) the 2021 Valuation Report reflects a valuation range for the Bellflower MWS exceeding the \$17 million purchase price, (2) we have already found in Section 3.1.1 that the purchase price is reasonable, and (3) the evidentiary record does not reflect that Cal-Am was not a willing buyer or that Bellflower was not a willing seller. Therefore, application of the FMV test under CCP § 1263.320(a) leads to the conclusion that \$17 million is the FMV of the assets of the Bellflower MWS. As a result, the rate base value of the assets of the Bellflower MWS is \$17 million, and we authorize the addition of \$17 million to Cal-Am's rate base to

²⁹ CCP § 1263.320(b).

³⁰ Pub. Util. Code § 2720(a).

³¹ Amended Application at 14.

³² Before the Settlement Agreement, Cal Advocates had presented evidence and argued that water rights might be excluded from the FMV estimation and rate base because water rights are not facilities. Exhibit Cal-PA 1 at 8, Cal Advocates Opening Brief at 5. Cal Advocates appears to have abandoned that argument by its execution of the Settlement Agreement. Even so, the Commission has recognized that water rights are properly considered as part of the total purchase price of a water utility's system in the determination of FMV under Pub. Util. Code § 2720. See D.07-08-022. We find it appropriate to include the valuation of the 700 acre-feet of water rights to be acquired by Cal-Am in the determination of FMV and rate base.

reflect the Acquisition purchase price to be effective at the close of the Acquisition simultaneously with the \$5 million rate base reduction discussed in Section 3.3 below.

3.3. Rate Base and Accounting Treatment of Bellflower \$5 Million Commitment

As set forth in Section 3.1.1 above, Bellflower has entered into an Infrastructure Agreement with Cal-Am under which Bellflower will deposit \$5 million into a trust fund at or before the close of the Acquisition to be made available to Cal-Am for post-Acquisition capital improvements to the Bellflower MWS. Paragraph 7.1(d) of the Settlement Agreement provides that the \$5 million will be accounted for as grant funding received at the Acquisition's close for ratemaking purposes, and the \$5 million will be recognized as contributions when made available and not when improvements are made. Cal-Am states that (1) the Settlement Agreement's provision for accounting treatment of the \$5 million as grant funding received at the close of the Acquisition will result in a reduction of \$5 million to Cal-Am's rate base upon close of the Acquisition,³³ and (2) upon completion of each capital improvement project utilizing Bellflower's grant funds, grant-funded assets will be booked to the asset account utility plant in service with a corresponding entry to the liability account Contributions in Aid of Construction (CIAC), with those accounts ultimately offsetting each other for a net zero impact to rate base.³⁴

In D.06-03-015, the Commission adopted rules applicable to all classes of regulated water utilities regarding the receipt and use of state grant funds. The rules were adopted to preserve the public interest integrity of state grant funds

³³ Exhibit Cal-Am 21 Attachment A at 17.

³⁴ Exhibit Cal-Am 21 Attachment A at 13.

by ensuring that investor-owned water utilities and their shareholders will not be able to profit in any way through the receipt of public funds.³⁵ A subsequent Commission decision held that local and federal government grants should be given substantially the same accounting and ratemaking treatment as state grants.³⁶

In D.16-11-006, the Commission adopted the current version of the Uniform System of Accounts (USOA) for Class A water utilities, including Cal-Am.³⁷ The USOA designates Account 265 for CIAC. The USOA description for Account 265 states that the account includes donations or contributions in cash, services, or property from states, municipalities, or other governmental agencies for construction purposes.³⁸ The USOA also specifies the procedure for the recording of grant funding entries to particular accounts from the time of the water utility's receipt of grant funds from the funding agency to the completion of construction.³⁹

Utility plant funded through government grants is accounted for in the same manner as CIAC, thereby ensuring that no return is earned by a water utility on grant-funded plant.⁴⁰ The ratemaking effect of adding amounts to CIAC is to reduce rate base by those same amounts.⁴¹

³⁵ D.06-03-015 at 3.

³⁶ D.10-10-018 at 32-33.

³⁷ The provisions of the USOA adopted in D.16-11-006 are contained in the California Public Utilities Commission Water Division Uniform System of Accounts for Class A Water Utilities Standard Practice U-38-W (January 2018).

³⁸ *Id.* at A45.

³⁹ *Id.* at A15.

⁴⁰ D.06-03-015 at 10-11; D.10-10-018 Ordering Paragraph 2 (contributions under Account 265 not eligible for rate base recovery or depreciation).

⁴¹ D.07-04-046 at 100.

Applying these principles to the facts in this case, Bellflower's \$5 million Infrastructure Agreement commitment to Cal-Am is a government grant to be accounted for under the USOA in the same manner as CIAC. In their Settlement Agreement, Cal-Am and Cal Advocates agree that the \$5 million will be accounted for as if it were grant funding received at the time of the Acquisition's close. Therefore, at the close of the Acquisition, Cal-Am's rate base will be reduced by \$5 million to reflect that Bellflower's \$5 million Infrastructure Agreement commitment is a government grant to be accounted for as a contribution to Cal-Am.

As a result of the rate base adjustments reflected in this section and in Section 3.2 above, Cal-Am's rate base will increase by \$12 million effective at the close of the Acquisition.

3.4. Memorandum Account Cost Tracking of Environmental Improvements and Compliance

Scoping Memo Issue 4 inquires whether the Commission should approve Cal-Am's request to track costs of environmental improvements and compliance related to the Acquisition. Cal-Am does not seek to establish a new memorandum account. Rather, it requests Commission approval to track the same types of costs in "The Memorandum Account for Environmental Improvements and Compliance Issues for Acquisitions" (Environmental Memorandum Account) that were previously authorized for Cal-Am acquisitions. In Cal-Am's GRC proceeding A.19-07-004, the Commission adopted a settlement that keeps this account open.⁴² Cal-Am has acknowledged that it will bear the burden to establish the reasonableness of such costs before they

⁴² D.21-11-018 at 134-135, Appendix B at 109.

may be recovered and that tracking costs does not guarantee recovery of costs.⁴³ No opposition to Cal-Am's request to track environmental costs was submitted. We find good cause exists to grant Cal-Am's request, and therefore we approve Cal-Am's cost tracking in the Environmental Memorandum Account.

3.5. New Memorandum Account Tracking of Acquisition Costs

Scoping Memo Issue 5 addresses whether the Commission should approve Cal-Am's request to establish a new memorandum account to track costs related to the Acquisition. Acquisition costs may include payments for legal, engineering, surveying, appraising, noticing, and other professional services necessary to complete the Acquisition.⁴⁴ New memorandum account costs are recoverable only when (1) they result from an event of an exceptional nature not under the utility's control, (2) they were not reasonably foreseeable in the utility's last GRC and will occur before the utility's next scheduled GRC, (3) the money involved is substantial, and (4) ratepayers benefit from the memorandum account treatment.⁴⁵ In this case, Cal-Am made the decision to purchase the assets of the Bellflower MWS and knew or should have known of the types of expenses it would incur to consummate the purchase, and therefore the costs that Cal-Am seeks to track in this account were not exceptional and were under the utility's control. Therefore, we deny Cal-Am's request to establish a new memorandum account to track costs related to the Acquisition.

⁴³ July 12, 2019 Cal-Am Opening Brief (Cal-Am Opening Brief) at 22.

⁴⁴ Exhibit Cal-Am 3 at 13-15.

⁴⁵ Commission Standard Practice U27W.

3.6. New Contingency Memorandum Account

Scoping Memo Issue 6 asks whether the Commission should allow Cal-Am to create a “contingency” memorandum account to capture the difference in revenue between the current rates and final rates if the Acquisition is approved. In its Opening Brief, Cal-Am states that this account is needed only if integration of the Bellflower MWS for ratemaking purposes is not possible for Cal-Am’s 2019 GRC.⁴⁶ However, as set forth in Section 3.14 below, Bellflower MWS ratemaking integration will occur pursuant to Cal-Am’s filing of a Tier 2 Advice Letter. In addition, the evidence does not support a conclusion that a revenue loss resulting from a delay in Acquisition approval constitutes an event of an exceptional nature. As a result, we deny Cal-Am’s request to allow it to create a contingency memorandum account.

3.7. Health or Safety Requirements

Scoping Memo Issue 8 inquires whether the Bellflower MWS is in violation of any health or safety requirements. Cal-Am has stated that it is not aware of any such violations.⁴⁷ Bellflower has also stated that it is not aware of any current violations of health or safety requirements.⁴⁸ The evidentiary record does not reflect that the Bellflower MWS is in violation of any health or safety requirements that would cause us to deny the Amended Application.

3.8. Qualification as Inadequately Operated and Maintained Small Water Utility

Scoping Memo Issue 9 concerns whether the Bellflower MWS qualifies as an Inadequately Operated and Maintained Small Water Utility and, if so,

⁴⁶ Cal-Am Opening Brief at 25-26.

⁴⁷ *Id.* at 32.

⁴⁸ July 12, 2019 City of Bellflower Opening Brief at 25.

whether the distressed incentives of D.99-10-064 should apply. Cal-Am has stated that the Amended Application does not allege that the Bellflower MWS qualifies as an Inadequately Operated and Maintained Small Water Utility,⁴⁹ and no party has alleged otherwise. Therefore, we do not find it necessary to further address this issue.

3.9. Public Utility Obligations Following Close of Acquisition

Scoping Memo Issue 13 asks whether the Bellflower MWS should be relieved of its public utility obligations following the close of the sale or when Cal-Am has obtained all applicable permits to operate the Bellflower MWS. The Bellflower MWS is a municipal utility whose operations are not regulated by the Commission. Therefore, we decline to state whether the Bellflower MWS should be relieved of its public utility obligations.

3.10. Notice to Cal-Am's Customers

Scoping Memo Issue 14 concerns whether Cal-Am's customers have been properly noticed pursuant to Rules 3.2 and 3.6. The evidentiary record reflects that Cal-Am served multiple notices on its customers regarding both the initial Application and the Amended Application.⁵⁰ Therefore, we find that Cal-Am has satisfied the notice requirements of Rules 3.2 and 3.6.

3.11. CEQA Review

Under Rule 2.4, applications for authority to undertake any projects that are subject to CEQA shall comply with the review requirements set forth in CEQA, the regulations implementing CEQA, and Rule 2.4. A project triggering a CEQA review is an activity that may cause either a direct or a reasonably

⁴⁹ Cal-Am Opening Brief at 32.

⁵⁰ Exhibit Cal-Am 3 at 28, Attachment 4.

foreseeable indirect physical change in the environment.⁵¹ In this proceeding, Cal-Am requests Commission approval of an Asset Purchase Agreement with Bellflower and a Settlement Agreement with Cal Advocates, not the authority to undertake a particular project. The Commission has held that CEQA review is not required when a water utility files an application for approval of the purchase of the assets of another water utility.⁵² Therefore, a CEQA review is not required in this proceeding. We recognize that the contractual agreements we approve in this decision may result in the future development of projects that are subject to CEQA review, and nothing in this decision is intended to alter our authority to review such projects.

3.12. Wheeling Agreement

Cal-Am has requested Commission approval for its Wheeling Agreement with Bellflower-Somerset. As part of the Acquisition, Cal-Am will acquire High Capacity Well No. 1 (HC Well No. 1), a well located in Bellflower-Somerset's service territory. Therefore, water from HC Well No. 1 must be wheeled through Bellflower-Somerset's distribution system before it reaches the Bellflower MWS service area. Under the Wheeling Agreement, Cal-Am will pay Bellflower-Somerset a fixed wheeling charge to transmit water from the Bellflower-Somerset system to the Bellflower MWS service area. The Wheeling Agreement also provides for Cal-Am to sell water to Bellflower-Somerset.⁵³

No objection to Commission approval of the Wheeling Agreement was submitted. Therefore, we approve the Wheeling Agreement.

⁵¹ Public Resources Code Section 21065.

⁵² D.21-08-002 at 38.

⁵³ Exhibit Cal-Am 3 at 16-17; Exhibit Cal-Am 20 Attachment A at 16-17.

3.13. Modification of Cal-Am's Certificate of Public Convenience and Necessity

This decision authorizes Cal-Am to provide service to the customers formerly served by the Bellflower MWS. Therefore, we modify Cal-Am's existing Certificate of Public Convenience and Necessity to include the service area of the Bellflower MWS.

3.14. Operational and Ratemaking Consolidation of Bellflower MWS with Cal-Am's Existing Service Area and Tier 2 Advice Letter

Scoping Memo Issue 3 identifies the issue whether and how the Bellflower MWS would be consolidated with Cal-Am's existing service area for operational and ratemaking purposes. D.21-11-018 adopted Cal-Am's request to consolidate the Los Angeles County, Ventura County, and San Diego County Districts into one Southern Division.⁵⁴ No evidence has been submitted and no party has argued that consolidation of the Bellflower MWS into Cal-Am's Southern Division service area for operational purposes should be delayed. Therefore, we approve the consolidation of the Bellflower MWS into the Southern Division for operational purposes effective on the close of the Acquisition.

A settlement adopted by the Commission in Cal-Am's 2019 GRC provides direction regarding the integration of the Bellflower MWS with the ratemaking authorized in that GRC. Because this decision is issued after D.21-11-018 in the GRC, D.21-11-018 directs Cal-Am to file a Tier 2 advice letter to incorporate this decision into authorized rates.⁵⁵ D.21-11-018's direction to file a Tier 2 Advice Letter is consistent with General Order 96-B, which requires a Tier 2 Advice Letter for the approval of post-acquisition rates of a municipal water

⁵⁴ D.21-11-018 at 140-141, Ordering Paragraph 14.

⁵⁵ *Id.* Ordering Paragraphs 2, 9, Appendix B at 120.

utility.⁵⁶ As a result, we order Cal-Am to file a Tier 2 advice letter no later than 30 days after the close of the Acquisition to implement the Commission's approval of the Acquisition reflected in this decision.

4. Cal-Am Requests to Admit Ruling Responses into Evidence

Cal-Am has requested that its responses to the December 21, 2021 and February 4, 2022 ALJ rulings be admitted into evidence. We grant the requests and admit into evidence Cal-Am's responses to the December 21, 2021 ruling as Exhibit Cal-Am 20 and its responses to the February 4, 2022 ruling as Exhibit Cal-Am 21.

5. Comments on Proposed Decision

The proposed decision of ALJ Peter Wercinski in this matter was mailed to the parties in accordance with Pub. Util. Code § 311, and comments of the parties were allowed under Rule 14.3. Comments were filed on _____ by _____, and reply comments were filed on _____ by _____.

6. Assignment of Proceeding

Clifford Rechtschaffen is the assigned Commissioner and Peter Wercinski is the assigned ALJ in this proceeding.

Findings of Fact

1. On October 20, 2017, Cal-Am and Bellflower-Somerset entered into the Wheeling Agreement for Bellflower-Somerset to transmit water from the HC Well No. 1 through Bellflower-Somerset's distribution system to the Bellflower MWS service area and for Cal-Am to sell water to Bellflower-Somerset.

⁵⁶ General Order 96-B Water Industry Rule 7.3.2(1).

2. On November 27, 2017, Cal-Am and Bellflower entered into an Asset Purchase Agreement for Cal-Am to purchase the assets of the Bellflower MWS from Bellflower for \$17 million.

3. On November 1, 2021, Cal-Am and Bellflower entered into an Infrastructure Agreement in which Bellflower agreed to make \$5 million available to Cal-Am before or at the close of the Acquisition for post-Acquisition capital improvements to the Bellflower MWS.

4. On November 23, 2021, Cal-Am and Cal Advocates entered into a Settlement Agreement and filed a Motion for Adoption of Settlement Agreement.

5. The FMV of the assets of the Bellflower MWS is \$17 million.

6. At the close of the Acquisition, Cal-Am's \$17 million purchase price for the assets of the Bellflower MWS will increase Cal-Am's rate base by \$17 million.

7. At the close of the Acquisition, Bellflower's \$5 million Infrastructure Agreement commitment will reduce Cal-Am's rate base by \$5 million.

Conclusions of Law

1. The Commission should approve the Amended Application and authorize Cal-Am's Acquisition of the assets of the Bellflower MWS from Bellflower pursuant to the Asset Purchase Agreement.

2. The Settlement Agreement is reasonable in light of the whole record, consistent with law, and in the public interest, and the Commission should grant the Motion for Adoption of Settlement Agreement.

3. Bellflower's \$5 million Infrastructure Agreement commitment to Cal-Am is a government grant that should be accounted for as a contribution under the USOA.

4. The Commission should approve Cal-Am's request to track costs of environmental improvements and compliance relating to the Acquisition in the Environmental Memorandum Account.
5. The Commission should deny Cal-Am's request to track Acquisition costs in a new memorandum account.
6. The Commission should deny Cal-Am's request to create a contingency memorandum account to capture the difference in revenue between current rates and final rates relating to the Acquisition.
7. The evidentiary record does not reflect that the Bellflower MWS is in violation of any health or safety requirements that would cause the Commission to deny the Amended Application.
8. Cal-Am has satisfied the customer notice requirements of Rules 3.2 and 3.6.
9. CEQA review is not required in this proceeding.
10. The Commission should approve the Wheeling Agreement.
11. Cal-Am's existing Certificate of Public Convenience and Necessity should be modified to include the service area of the Bellflower MWS.
12. The Commission should approve the consolidation of the Bellflower MWS into Cal-Am's Southern Division service area for operational purposes.
13. The Commission should order Cal-Am to file a Tier 2 advice letter no later than 30 days after the close of the Acquisition to implement the Commission's approval of the Acquisition reflected in this decision.
14. The Commission should grant Cal-Am's request to admit into evidence Cal-Am's responses to the December 21, 2021 and February 4, 2022 ALJ rulings.
15. Except as otherwise provided in this decision, this decision should be effective immediately.

16. This proceeding should be closed.

O R D E R

IT IS ORDERED that:

1. The January 22, 2019 amended application of California-American Water Company (Cal-Am) to authorize Cal-Am's acquisition of the assets of the Bellflower Municipal Water System (Bellflower MWS) from the City of Bellflower (Bellflower) pursuant to the November 27, 2017 Asset Purchase Agreement between Cal-Am and Bellflower (Acquisition) is approved. At the close of the Acquisition, Cal-Am's rate base shall increase by \$17 million to reflect Cal-Am's Acquisition of the assets of the Bellflower MWS.

2. The November 23, 2021 joint motion by California-American Water Company (Cal-Am) and the Public Advocates Office (Cal Advocates) for the adoption of the settlement agreement between Cal-Am and Cal Advocates attached to this decision as Attachment 1 is granted.

3. The \$5 million commitment by the City of Bellflower (Bellflower) to California-American Water Company (Cal-Am) in the November 1, 2021 Agreement Regarding Water Infrastructure Improvement Funding (Infrastructure Agreement) between Cal-Am and Bellflower is a government grant that shall be accounted for as a contribution under the Uniform System of Accounts. At the close of the acquisition by Cal-Am of the assets of the Bellflower Municipal Water System from Bellflower, Cal-Am's rate base shall be reduced by \$5 million to reflect Bellflower's \$5 million Infrastructure Agreement commitment.

4. As a result of the rate base adjustments reflected in Ordering Paragraphs 1 and 3, effective at the close of the acquisition by California-American Water

Company (Cal-Am) of the assets of the Bellflower Municipal Water System, Cal-Am's rate base shall increase by \$12 million.

5. The request of California-American Water Company (Cal-Am) to track costs of environmental improvements and compliance relating to Cal-Am's acquisition of the assets of the Bellflower Municipal Water System in Cal-Am's Memorandum Account for Environmental Improvements and Compliance Issues for Acquisitions is approved.

6. The request of California-American Water Company (Cal-Am) to track costs relating to Cal-Am's acquisition of the assets of the Bellflower Municipal Water System in a new memorandum account is denied.

7. The request of California-American Water Company (Cal-Am) to create a contingency memorandum account to capture the difference in revenue between current rates and final rates upon approval of Cal-Am's acquisition of the assets of the Bellflower Municipal Water System is denied.

8. The October 20, 2017 Agreement for Transmission and Production of Water between California-American Water Company and Bellflower-Somerset Mutual Water Company attached to this decision as Attachment 2 is approved.

9. California-American Water Company's existing Certificate of Public Convenience and Necessity is modified to include the service area of the Bellflower Municipal Water System.

10. The consolidation of the Bellflower Municipal Water System (Bellflower MWS) with the Southern Division service area of California-American Water Company (Cal-Am) for operational purposes is approved effective on the close of Cal-Am's acquisition of the assets of the Bellflower MWS.

11. No later than 30 days after the close of the acquisition by California-American Water Company (Cal-Am) of the assets of the Bellflower Municipal Water System, Cal-Am shall file a Tier 2 advice letter that implements this decision for ratemaking purposes.

12. The request of California-American Water Company (Cal-Am) to admit its responses to the December 21, 2021 and February 4, 2022 Administrative Law Judge (ALJ) rulings into evidence is granted. Cal-Am's responses to the December 21, 2021 ALJ ruling are admitted into evidence as Exhibit Cal-Am 20, and Cal-Am's responses to the February 4, 2022 ALJ ruling are admitted into evidence as Exhibit Cal-Am 21.

13. Except as otherwise provided in this decision, this decision is effective immediately.

14. Application 18-09-013 is closed.

Dated _____, at Fresno, California.