



BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

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Order Instituting Rulemaking to review the existing guiding framework set forth in Decision 99-10-064 (consistent with the Public Water System Investment and Consolidation Act of 1997) regarding acquisitions involving water utilities under the Commission's jurisdiction.

Rulemaking 22-04-003

**THE PUBLIC ADVOCATES OFFICE AT THE
CALIFORNIA PUBLIC UTILITIES COMMISSION'S
COMMENTS ON WORKSHOP I**

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Pursuant to Administrative Law Judge Gerald F. Kelly’s February 10, 2023 Ruling providing the workshop report from Workshop 1¹ and requesting opening and reply comments, the Public Advocates Office at the California Public Utilities Commission (Cal Advocates) provides the following comments.

I. INTRODUCTION

Cal Advocates believes that the Workshop Report captures many of the important issues and possible solutions raised during the November 29, 2022, Workshop that the Commission should consider when reviewing the existing guiding framework for acquisitions involving water utilities under the Commission’s jurisdiction. To further ensure a full and robust record, Cal Advocates herein provides additional information in response to specific questions identified in the Scoping Memo and Ruling and considered at Workshop 1.

II. HOW SHOULD THE COMMISSION ASSESS WATER UTILITY ACQUISITIONS OF INADEQUATELY OPERATED AND MAINTAINED SYSTEMS?

The Commission should assess water utility acquisitions by the progress regulated entities make toward the advancement of state policy goals, namely the Human Right to Water (HRW) and the Commission’s Environmental & Social Justice Action Plan (ESJ Action Plan). The Commission has a required leadership role in securing the Human Right to Water for all Californians.² The HRW states every human being has the right to safe, clean, affordable, and accessible water.³ By prioritizing the HRW as a core value, the State Water Board (SWB) established a HRW list of systems that consistently fail to meet primary drinking water standards.⁴ The Commission can effectively meet its leadership role in coordination with the SWB by adopting a revised framework that similarly prioritizes and promotes the acquisition of

¹ Water Division Summary Report on Workshop #1, Options for Inadequately Operated & Maintained Systems, dated February 10, 2023 (Workshop Report).

² Cal Water Code Sec. 106.3 (b) All relevant state agencies ...shall consider the Human Right to Water when revising, adopting, or establishing policies, regulations, and grant criteria when those policies, regulations, and criteria are pertinent to the uses of water described in this section.

³ Cal Water Code Sec. 106.3 (a).

⁴ “Failing Water Systems: The Human Right to Water (HR2W) List Criteria” California Water Boards, April 2021, at 3.

Inadequately Operated & Maintained Water Systems (IOMs) in close proximity to regulated entities.

The Commission has repeatedly stated that consolidations are a tool to remedy “‘struggling’ systems [with] failing water quality health and safety standards”.⁵ The Commission has further explained that when considering consolidations, Class A Water Investor Owned Utilities (IOUs) must be encouraged to “thoroughly consider acquiring at-risk systems” and that “communities designated as disadvantaged should be prioritized.”⁶ Despite these directives, IOUs have largely ignored state policy when deciding which water systems to acquire. Of the 70 IOU acquisition proceedings tracked by Cal Advocates between 2000 and 2022, 90% of Class A dollars (\$504 million) have been spent acquiring systems with more than 2000 connections.⁷ UCLA’s presentation affirmed this existing inequity by showing that consolidations statewide occur in “high-resourced communities... at more [than] twice of load-resource communities.”⁸

Unlike the overwhelming majority of communities that have been merged into IOU service territories through acquisitions, all of California’s water system policies and the Commission’s ESJ Action Plan target disadvantaged communities.⁹ Despite the Commission’s

⁵ D.20-08-047 at 4 & 36; D.14-10-047 at 17.

⁶ D20-08-047 at 38.

⁷ Workshop Report at 9. Small public water systems are often less resilient to natural disasters, such as drought and fire, have more difficulty adjusting to regulatory changes, and may struggle to fund infrastructure maintenance and replacement due to poor economies of scale and lack of staff. (Drinking Water Partnerships and Consolidation | California State Water Resources Control Board: https://www.waterboards.ca.gov/drinking_water/certlic/drinkingwater/waterpartnership.html) In addition, in excess of 90 percent of drinking water violations occur in water systems serving fewer than 500 connections (<https://calmatters.org/wp-content/uploads/2021/12/Safe-Drinking-Water-Plan-for-California-September-2021.pdf>). Approximately 92% of the >7,500 public water systems and 77% of the community water systems in California serve less than 1,000 connections (https://www.waterboards.ca.gov/drinking_water/certlic/drinkingwater/waterpartnership.html) (<https://calmatters.org/wp-content/uploads/2021/12/Safe-Drinking-Water-Plan-for-California-September-2021.pdf> at p. 8).

⁸ Workshop Report at 5.

⁹ See AB 685, SB 88, SB 552, AB 2501, SB 200, SB 403, & SB 552 described in “California Capacity Development Strategy for Public Water Systems: 2022 Revised Draft Strategy Outline” at 7-15. (https://www.waterboards.ca.gov/drinking_water/certlic/drinkingwater/docs/2022/2022-CapDev-Revised-Draft-Strategy.pdf) Also see ESJ Action Plan, 2.0 Executive Summary at 5. (“ESJ Communities for the purpose of CPUC policy and programs, [are defined] as predominantly communities of color or low-income communities that are underrepresented in the policy *following* communities: *Disadvantaged Communities*, defined as census tracts that score in the top 35% of CalEnviroScreen 3.0, along with those

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mission to prioritize small failing systems, the total spending by IOUs to acquire small, failing water systems has been a small fraction of all IOU spending on acquisitions in the 25 years since passage of the Act.¹⁰

Presented with clear evidence that IOUs are ignoring, if not impeding, state policy with their acquisition track record, the California Water Association (CWA) repeatedly recommended the “removal of procedural barriers and the addition of incentives for acquisitions of *potential* IOMs as a measure to prevent those water systems from becoming IOMs.”¹¹ CWA’s recommendation not only misses the mark to “bring attention to ESJ communities... and Native American tribes,” it asks the Commission to ignore its failure to address known small failing and HRW systems, and allow it to address the ill-defined and more likely more lucrative market of “potential”, IOMs.¹²

To address the IOU’s failure to effectuate state policy in this area, Cal Advocates suggests the IOUs be required to conduct feasibility studies to identify the possibility of connecting to all failing systems within five miles of their IOU districts to assist the Commission in determining if acquisition applications address, advance or impede the HRW.¹³ The Commission and SWB can cross-reference these systems with those on the HRW list and use the State Water Board’s Drinking Water System Outreach tool and Cal Advocates Troubled Water Systems Proximity Tool to determine how to most effectively and efficiently solve regional water problems.

III. ARE THE INCENTIVES FOR ACQUISITIONS PROVIDED FOR UNDER THE PUBLIC WATER SYSTEM INVESTMENT AND CONSOLIDATION ACT STILL REASONABLE OR NECESSARY TO ACHIEVE COMMISSION POLICY GOALS?

The 1997 Public Water System Investment and Consolidation Act (the Act) applies to all acquisitions but because small public water systems are often less resilient to natural disasters,

that score within the highest 5% of CalEnviroScreen 3.0’s Pollution Burden but do not receive an overall CalEnviroScreen score; *Al Tribal lands; Low-income households...; Low-income census tracts...*”) (*emphasis added*) (<https://www.cpuc.ca.gov/-/media/cpuc-website/divisions/news-and-outreach/documents/news-office/key-issues/esj/esj-action-plan-v2jw.pdf>).

¹⁰ Cal Advocates presentation at Workshop 1, slide 5.

¹¹ Workshop Report at 11.

¹² Workshop Report at 11.

¹³ Workshop Report at 10.

such as drought and fire, have more difficulty adjusting to regulatory changes, and may struggle to fund infrastructure maintenance and replacement due to poor economies of scale and lack of staff,¹⁴ the Act was intended to incentivize larger water systems to consolidate with or acquire small, failing water systems to provide safe and affordable water to all Californians.¹⁵

Unfortunately, the promise of this Act to address small failing systems has remained largely unfulfilled in the 25 years since passage of the Act as the total spending by IOUs on acquisitions of small, failing water systems has been a small fraction of all acquisition spending.¹⁶ This should come as no surprise because the incentives provided by the Act focused on valuations rather than remedying the problems of “struggling” systems.¹⁷

Though the Act applies to the acquisition of failing and non-failing systems alike, the incentive to sell systems at an amount greater than the invested capital (i.e. a premium greater than the book value) heightened sellers’ interest; it allows them to sell non-failing systems at steep premiums, resulting in an increase in acquisitions of non-failing systems.¹⁸ By contrast, failing systems have less been able to avail themselves of these purchase premium incentives

¹⁴ https://www.waterboards.ca.gov/drinking_water/certlic/drinkingwater/waterpartnership.html.

¹⁵ Cal Pub Utilities Code (2718-2720) (See 2018 Amendment (ch 866) of Cal Pub Util Code Section 10061, Section 1(c) and (e) which state:

(c) Small water systems often lack adequate resources or expertise to operate in compliance with increasingly stringent and complex safe drinking water quality standards, which are required to protect public health and safety, and are unable to bear the cost of replacing and upgrading aging and failing water service infrastructure. As a result, many small water suppliers are too small to be viable, raising questions as to whether they will be able to provide safe and reliable water service to the public now or in the future. Many small water suppliers are in such precarious financial condition that basic infrastructure maintenance is infeasible, and in many cases, maintenance and replacement of failing infrastructure is deferred. These water suppliers also have such small customer bases that additional investment is not affordable.

(e) Therefore, it is the policy of the State of California to consolidate small public water systems when (1) the water supplier cannot feasibly provide or ensure access to affordable water services to a community... and (3) water systems have deferred maintenance on their aging or failing water supply infrastructure.”

¹⁶ Cal Advocates presentation at Workshop 1, slide 5.

¹⁷ D.20-08-047 at 4 & 36; D.14-10-047 at 17.

¹⁸ Examples include D. 21-08-002 (East Pasadena had a \$34M purchase price despite a \$4M estimated book value); D. 22-12-002 (Montebello had a \$15.5M purchase price despite a \$1.1 estimate book value); and D. 22-10-003 (Bellflower had a \$12M net realized purchase price despite a \$2M estimated book value).

because acquisitions that produce a windfall from failing systems requiring extensive resources and are less likely to appear reasonable before the Commission.¹⁹

The inequitable result of incentives for non-failing systems is amplified by the gain on sale rules—which allow the seller to retain the entire profit or gain on the sale.²⁰ Even in situations where an IOU is purchased by another IOU and the Commission’s gain-on-sale rules are not applied, ratepayers do not share in the gain on the sale of assets they funded while simultaneously funding the gain to the seller through higher rates charged by the acquiring IOU. This inequity creates a situation where the acquisition of healthy, non-failing systems is incentivized for buyers, who can overpay for facilities (at no cost to themselves) to increase ratebase, and sellers who want to overcharge and gain a windfall.

Looking back, the IOU’s interpretation and implementation of the Act is counter to Commission policy and it hardly seems reasonable any longer. The lion’s share of acquisition investments have gone to non-failing systems in communities that neither needed the benefits nor felt the acute burden of increased rates instead of the disadvantaged communities that most need state-supported acquisitions.

To advance state policy goals through acquisitions, the Commission should re-focus its framework on struggling systems. As shown above, IOUs have more than adequate financial incentives to acquire non-failing water systems. By not incentivizing the acquisition of non-failing systems the Commission can place failing-systems on more equal footing consistent with state policy.

IV. WHAT ARE WAYS FOR THE COMMISSION TO APPROACH ACQUISITIONS OR CONSOLIDATIONS OF WATER UTILITY SYSTEMS IN DISADVANTAGED COMMUNITIES TO FURTHER PROMOTE THE COMMISSION’S ENVIRONMENTAL AND SOCIAL JUSTICE ACTION PLAN?

The Commission’s ESJ Action Plan commits to improving access to high-quality water through resilience, reliability, and consolidation of small water systems; deepening prioritization

¹⁹ Indeed, the handful of acquisitions of failing systems by IOUs for less than book value—i.e., no premium incentive applied, have been uncontested at the Commission. Examples include, Cal Water/Kings Mountain (AL. 2463), Golden State/Robbins (AL. 1818-W), and Cal Water/Crane Ridge (AL 2343).

²⁰ R.22-04-003, Comments of The Public Advocates Office On Order Instituting Rulemaking, page 8 (discussion of gain on sale).

of environmental and social justice communities in key proceedings; and enhancing outreach and public participation.

Without concerted efforts to prioritize IOU acquisitions toward failing systems in disadvantaged communities, the current pattern of consolidations will result in deepening disparities of access to safe drinking water. As explained by the Rural County Representatives of California, “the Commission should map areas where investments are proposed and ensure that [the Commission] doesn’t, in effect, allow ‘redlining’ in large areas of the state.”²¹ Cal Advocates’ has heeded this recommendation in creating the Troubled Water Systems Proximity Tool to prioritize where limited funds are urgently needed to advance the HRW.

Further, as UCLA noted in Workshop I, to prevent the ravages and burdens that are becoming increasingly common through extreme weather events, the Commission should also prioritize identifying systems that are in wildfire and drought-prone areas.²² Utility size should be taken into consideration when conducting this prioritization analysis as small systems are most vulnerable to shocks of extreme weather.²³

Numerous environmental and environmental justice organizations also recommended the Commission improve access and transparency to decision-making including: access to agency visualization tools; single page notice of proceedings that impact ESJ communities with links to comment opportunities; easily searchable supporting documents including Advice Letters and Proposed Decisions; creation of alerts by zip code or topic to notify community members of relevant actions and updates; and multi-lingual technical assistance to help interested community members apply programs such as the Customer Assistance Program.²⁴ The Commission should marshal its growing news and outreach resources to ensure these public participation improvements are implemented.

By refocusing the acquisition framework on failing systems in disadvantaged communities the Commission will squarely address the ESJ Action plan goals related to vulnerable water systems and the communities they serve.

²¹ Rural County Representatives of California Comments on ESJ Action Plan 2.0, p. 3, Nov. 22, 2021.

²² Workshop Report at 5.

²³ https://www.waterboards.ca.gov/drinking_water/certlic/drinkingwater/waterpartnership.html.

²⁴ California Environmental Justice Alliance et al. Comments on ESJ Action Plan 2.0, p. 3, Nov. 22, 2021.

V. ARE THE INCENTIVES FOR ACQUISITION OF AN INADEQUATELY OPERATED AND MAINTAINED SYSTEM PROVIDED FOR IN DECISION 99-10-064 SUFFICIENT TO ACHIEVE COMMISSION POLICY GOALS?

From the perspective of California ratepayers, the questions surrounding the issue of incentives ultimately arrive at the same principal, ensuring ratepayer fairness. IOUs' acquiring small failing systems is an important tool to address the challenges of small failing systems and secure the HRW for all Californians. However, IOUs have leveraged incentives intended for IOMs to acquire non-failing systems at a premium purchase price.

VI. WHAT KEY FACTORS SHOULD THE COMMISSION AND THE STATE WATER RESOURCES CONTROL BOARD (SWB) CONSIDER IN ANY COORDINATION EFFORTS BETWEEN THE TWO AGENCIES FOR INADEQUATELY OPERATED AND MAINTAINED SYSTEMS? WHAT ADDITIONAL OR ALTERNATIVE INCENTIVES COULD BE USED TO SUPPORT THE ACQUISITION OF INADEQUATELY OPERATED AND MAINTAINED WATER UTILITY SYSTEM?

One potential avenue that was not addressed during the workshop would be for the Commission and the SWB to expand their Memorandum of Understanding to include a Joint Task Force that would study, develop recommendations, and implement solutions to ensure that water system acquisitions prioritize failing water systems those in underserved communities. For example, the Joint Task Force could start with cross-referencing IOU district in close proximity to failing systems serving DACs; reviewing acquisition feasibility studies provided by IOUs; identifying common regional problems that could be addressed by pooled resources in regions; coordinating outreach efforts to ratepayers served by failing systems; identifying grant funding opportunities available for those systems and addressing perceived delays in receiving grant funding; and, work towards limiting liabilities for acquiring IOUs for past violations by acquired small failing systems.

In this regard, Cal Advocates has taken proactive steps to improve communications and coordination with the SWB and remains open and available to launching the Joint Task Force.

Respectfully submitted,

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