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R2204003

Workshop #3

Ratepayer Impacts

R.22-04-003 Water Acquisitions Rulemaking

June 13, 2023

9:00 AM – 4:00 PM



California Public
Utilities Commission

Workshop Information

- This is the third of four workshops.
- This workshop is being conducted virtually through Webex.
- All attendees will be automatically muted upon entry.
- The public will be given opportunities to provide comment.
- The chat box feature should not be used for formal comment. Attendees may use the chat box to message the host to ask general questions, note technical issues, or request to speak.
- This workshop is a formal CPUC event and will be recorded.
- The Water Division will issue a report afterwards summarizing the workshop.





Webex Webinar Participant Guide

Un-Mute
or Mute

(only once the Host has unmuted you)

See the meeting participants

Click to see the chat
and enter questions

"Raise Hand" button

Enable Closed Captioning



Gray means "on" (Not Muted, Sharing Video)

Red means "off" (Muted, Not Sharing Video)

Safety Message (Remote Work Edition)

➤ Check Your Posture Regularly

Maintain proper posture, paying careful attention to positioning of head, neck, spine, arms, wrists, hips, thighs and feet.



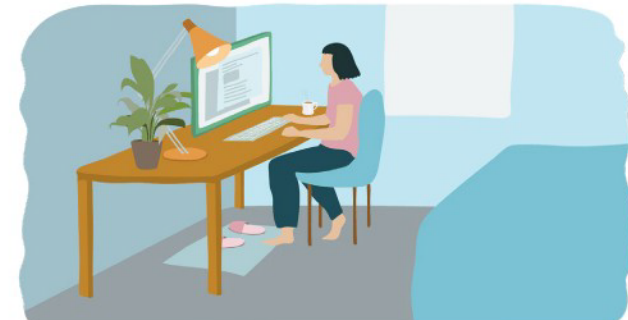
➤ Take Mini Breaks

We will provide scheduled breaks, however, don't hesitate to take a mini break use this time to get up, stretch and move around.



➤ Ensure Walking Paths and Doorways are Unobstructed

This will help prevent slips, trips or falls and keep paths clear in case of an emergency.



Opening Remarks

Morning Session

Ratepayer Impacts

Considerations for Ratepayer Impacts of Acquisition

Greg Pierce
Co-Director, Luskin Center for Innovation
Director, Water Resources Group
Faculty, Department of Urban Planning
June 13, 2023

UCLA

**Luskin Center
for Innovation**

Questions of interest

1. **How should the Commission examine ratepayer impacts when reviewing water utility acquisitions? What tests and criteria should be used, if any?**
2. **Should the impacts on existing customers of the acquiring water utility be included in the review of ratepayer impacts?**
3. How should the Commission measure the benefits and costs of water utility acquisitions?
4. Should rate impacts from previous acquisitions be assessed when reviewing a proposed water utility acquisition? If so, how?

My comments here are focused on non-municipal systems, out of compliance systems

- (in line with Staff White Paper commentary that “the incentives for acquiring well-maintained systems should be decreased”)

Work on statewide affordability

Recommendations for
Implementation of a Statewide
Low-Income Water Rate
Assistance Program



Work on Statewide Needs Assessment




**Risk
Assessment**

Systems \leq 3,300 conn.; K-12
Schools; SSWS, & DWs



**Cost
Assessment**

HR2W & At-Risk Systems
and Domestic Wells



**Affordability
Assessment**

DAC/SDAC Community Water
Systems

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

CALIFORNIA WATER BOARDS

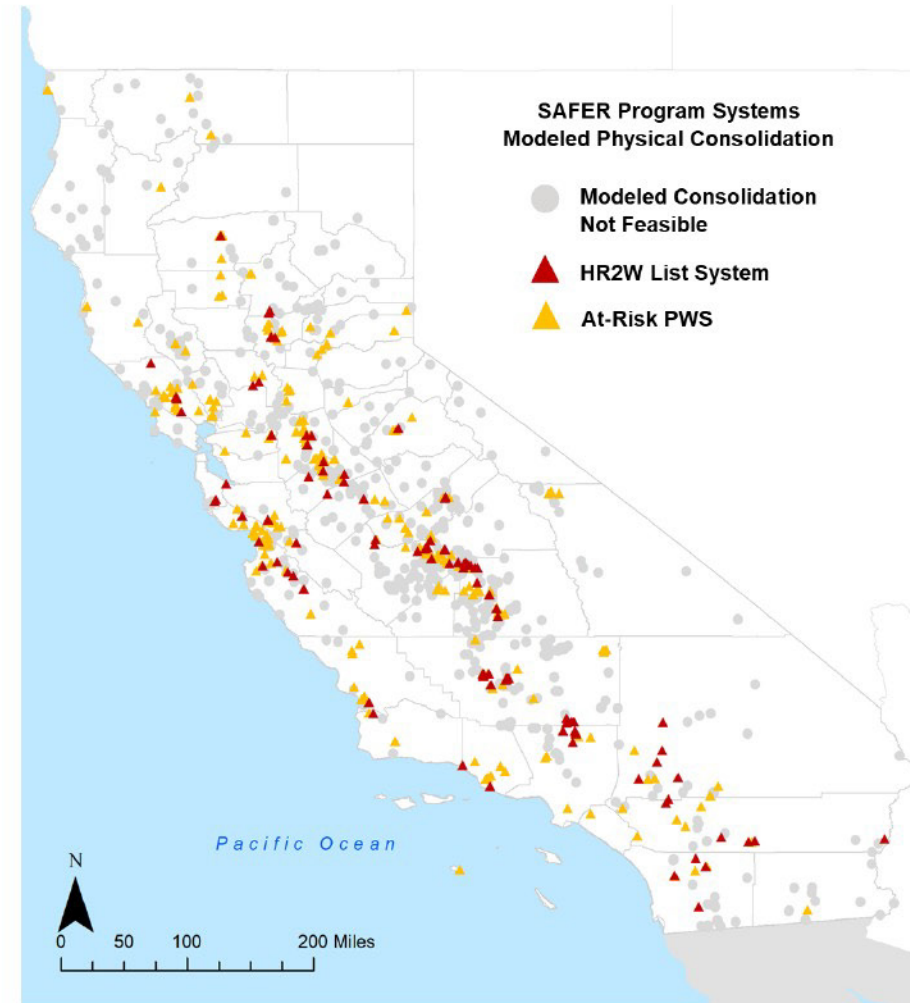
SAFER PROGRAM

Physical Consolidation is a limited strategy, part 1

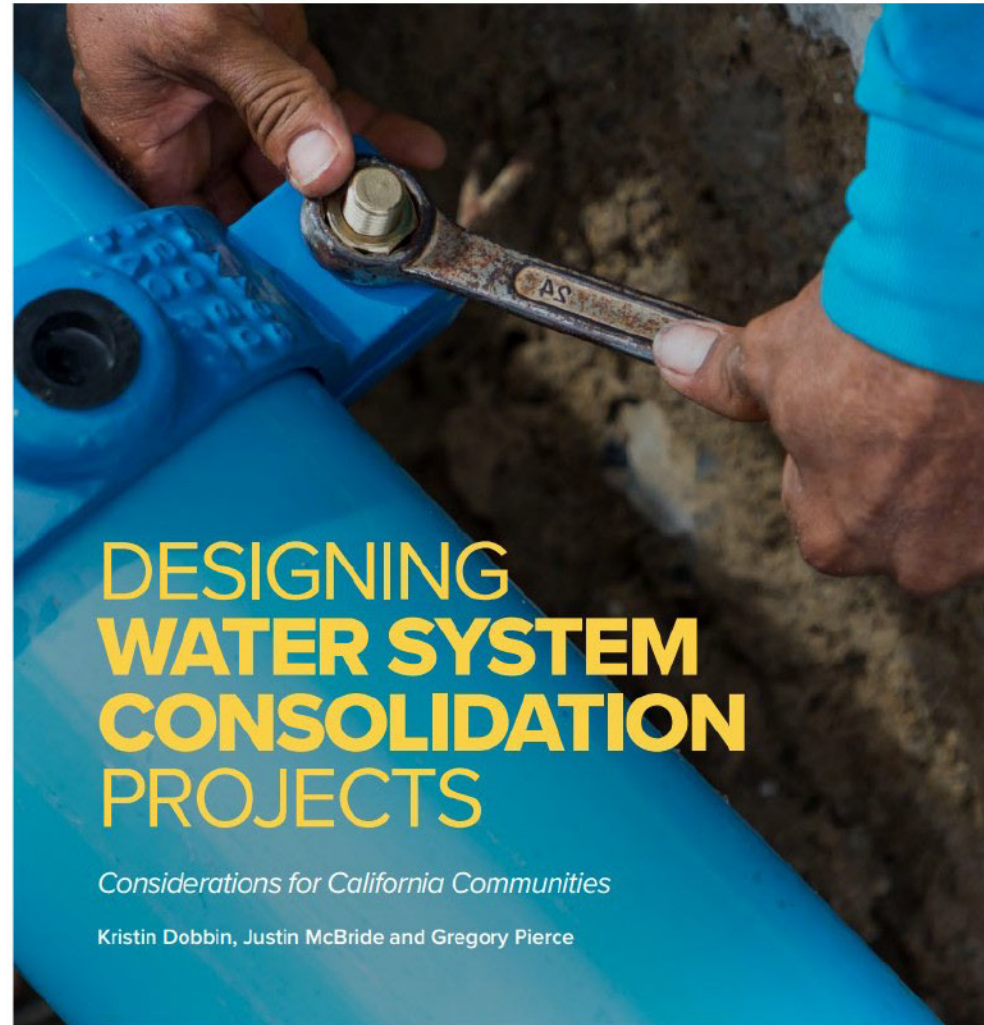
Potential Consolidation Map

Physical consolidation (one-to-one) was considered as a *potential solution* for **107 HR2W** list systems and **234 At-Risk** public water systems.

Significant potential cost savings can occur with **regionalization** as opposed to one-to-one consolidations. However, this analysis was not included in the aggregated cost estimate due to unknowns about boundary challenges and community acceptance.



Physical Consolidation is a limited strategy, part 2



“Revised Framework” from White Paper

- There are self-identified contradictions in statute which require tradeoffs and or better prioritization in ratepayer impact goals
- There are self-identified contradictions in case by case weighting of these tradeoffs by ALJs, etc.
- The white paper does not present a path forward except to raise a number of overarching and detailed questions that need to be resolved

“What would a new procedural structure look like”

1. Start with the need for every regulated public water system to provide safe drinking water compliant w the Porter Cologne Act
 - Compliance with PCA/SDWA is not under primary PUC purview
 - Non compliance motivates consolidation/acquisition
 - So, as noted in white paper, coordination efforts between the Commission and the SWRCB need to be improved on to address inadequately operated and maintained systems

“What would a new procedural structure look like”

2. Board and community must lead consolidation regarding if IOU is best or only consolidator or regionalization option,

- IF its determined that IOU is the best (only) option for consolidation, PUC settle on a purchase value and revenue flow through combined system rate structure that allows for reasonable rate of return
- If you don't then, there's simply no reason for an IOU to get involved
 - There may be exceptions to this rule, but not generally

“What would a new procedural structure look like”

3. If IOU is best option, make sure water is affordable (to both systems' customers) per existing state standard options:

- Do best to ensure this through valuation and GRC process but if not possible, state subsidies need to come in
- The current lack of consideration of receiving system ratepayers is unacceptable
- Stipulations around “no rate impact” are too restrictive and 5 year guarantees are not restrictive enough

Potential backstop affordability metrics

Table 5: Affordability Indicators 2020 – 2023

| Indicators | Household / Community | Rates-Based? | 2021 | 2022 | 2023 |
|---|-----------------------|--------------|------|------|------|
| Percent of Median Household Income (%MHI) | Community | Yes | ✓ | ✓ | ✓ |
| Extreme Water Bill | Community | Yes | ✓ | ✓ | ✓ |
| % Shut-Offs (Removed 2022) ¹⁷ | Household | Yes | ✓ | | |
| Percentage of Residential Arrearages (Removed 2023) ¹⁸ | Household | Yes | | ✓ | |
| Residential Arrearage Burden (Removed 2023) ¹⁹ | Community | Yes | | ✓ | |
| NEW: Household Socioeconomic Burden | Community | No | | | ✓ |

Source: 2023 Drinking Water Needs Assessment,
https://www.waterboards.ca.gov/drinking_water/certlic/drinkingwater/documents/needs/2023affordabilityassessment.pdf

Subsidiary questions/answers fall into line

- Nearly all of the other questions on valuation raised need to be subsidiary to these 3 guiding steps when it comes to out of compliance systems
- PUC needs to clarify its framework for ratepayer impacts first
- SWRCB need to lead the charge on a fund which could backstop affordability standard for consolidated systems
 - SAFER funds do not currently do this
 - Time period and intent for ongoing assistance likely needs further legislative support

Thank you!

Contact: gspierce@ucla.edu

Ratepayer Impacts

Time: 30 mins

Water Utility Acquisitions: Protecting Consumer Interests

ROGER COLTON
BELMONT, MA
JUNE 2023

Issue #1: How should the Commission examine ratepayer impacts when reviewing acquisitions

- A focus on process
 - A focus on outcomes
 - Affordability
 - Equity
 - A focus on transparency
 - A quick look at measuring costs and benefits
-

Examining ratepayer impacts: A focus on process

- Transparency: Public access to:
 - All studies, proposals, and information of the acquired and acquiring entities
 - Proposed contracts
 - Long-term capital / affordability plans
 - Meaningful Public Participation (a defined term in environmental equity circles):
 - Public hearings, public comment period
 - Prior to irrevocable commitments
 - Public Approval:
 - Referendum prior to sale or lease
-

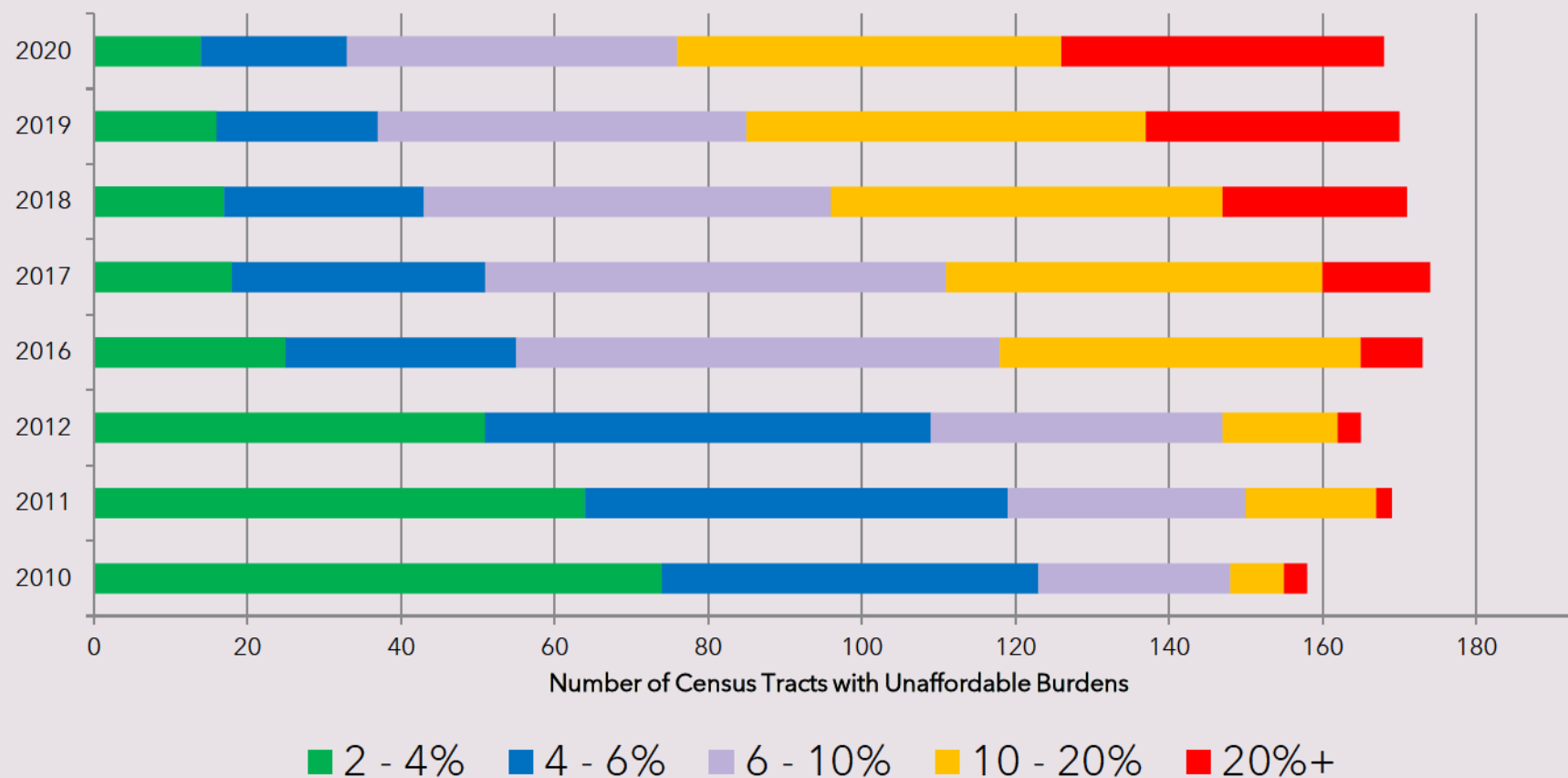
Examining ratepayer impacts: A focus on outcomes

- Distinguish from activities (not “what are you doing” but “what are you accomplishing”)
 - Involves:
 - Setting measurable objectives
 - Objectives influenced, not merely controlled
 - Continuous monitoring: what “is” versus what “should be”
 - Purpose of outcome focus:
 - Measure progress toward whether outcomes have been achieved
 - If not, determine cause of “why not”
 - Assign accountability
 - Make decisions / allocate resources
-

Examining ratepayer impacts: affordability

- Three-step measurement of affordability
 - Identify low-income customers
 - Enroll low-income customers in appropriate programs
 - Offer sufficient assistance to change payment practices
 - Measure two aspects of long term- ratepayer affordability (e.g., consider capital investment riders [e.g. QIP: Qualified Infrastructure Programs])
 - Consider Baltimore
 - Breadth of unaffordability
 - Depth of unaffordability
-

Baltimore Water Affordability / Unaffordability: “Depth” and “Breadth” in one Figure



Examining ratepayer impacts: equity

- Three different types of "equity"
 - Horizontal equity (devote an equal amount of resources to achieve objective)
 - Vertical equity (amount of resources explicitly varied to reflect differences in needs)
 - Equity-plus (are resources sufficient to accomplish sought-after objective)
 - Equity generally used to measure two factors:
 - Distribution of burdens
 - Distribution of amenities
 - In acquisition cases, different tests of equity applied to:
 - Affordability
 - Customer service
 - Water quality
 - System adequacy
 - Geo-targeted equity
 - "Wrong Side of the Tracks"
-

Examining ratepayer impacts: transparency

- Public records availability
 - Data collection (data elements):
 - Collectability (bills and receipts)
 - Failure to pay (aging of arrears, "bills behind")
 - Efficacy of collections (DPA success, response to DNP notices)
 - DNPs / uncollectibles
 - Public reporting
 - Sufficient periodicity (monthly, even if submitted annually)
 - Sufficient geo-targeting (zip codes, zip+4)
 - Matching with demographics (e.g., income, race)
-

Quick look at measuring costs and benefits

- **"Cost / benefit" analysis is often mis-used**
 - Does not specify the public policy decision that has been made
 - Would need to identify the entire range of benefits over time.
 - Assumes all financial and economic benefits can be identified, dollarized and measured.
 - Requires the utility to identify the incremental costs of the bill affordability program.
 - **Cost/benefit analysis is generally perspective-dependent**
 - "Insider" costs/benefits
 - "Outsider" cost/benefits
 - "Social" cost/benefits
 - **Perhaps more appropriate: "cost-effectiveness" analysis.**
 - Keeps focus on outcome measurements
 - Takes account of "effectiveness" of accomplishing outcomes
 - Improves before-the-fact transparency
-

Consider the “cost-effectiveness plane”

| | |
|---------------------------------|---------------------------------|
| Less effective / more expensive | More effective / more expensive |
| Less effective / less expensive | More effective / less expensive |

Applicability of “ratepayer impact” to questions:

The responses march forward from discussion above:

- Should impacts on existing customers be included?
 - How should Commission measure “benefits” and “costs” of acquisition:
 - Should the Commission consider cost-sharing mechanisms between ratepayers and shareholders?
-

ESJ Action Plan

Time: 30 mins

Environmental and Social Justice considerations – intersection with acquisitions in alignment with ESJ action plan

David L. Feldman, PhD
School of Social Ecology
Director, Water UCI
University of California, Irvine

**3rd Workshop for Acquisition Rulemaking at the
California Public Utilities Commission (CPUC)**

June 13, 2023

Water UCI



Overview

- Smaller utility systems in disadvantaged communities face challenges in upgrading water supply, delivery, wastewater treatment infrastructure and services.
- Partnering with larger, better financed suppliers is one remedy via acquisition & consolidation.
- CPUC decisions in this domain should proactively address *ESJ Action Plan criteria*:
 - Target disadvantaged communities,
 - Address needs of tribal lands,
 - Address low-income households and census tracts.

How address these communities' needs?

- Anticipate possible action *before* failure is incurred.
- Use LAFCo guidance on equitable collaboration.
- Enhance consultation with tribal nations.
- Support water agency efforts to become more diverse and inclusive.
- Confer with vulnerable communities on financing options.

Failed water systems

Since 2017 the Number of Water Systems Classified as Failing Each Year Has Remained Above 300

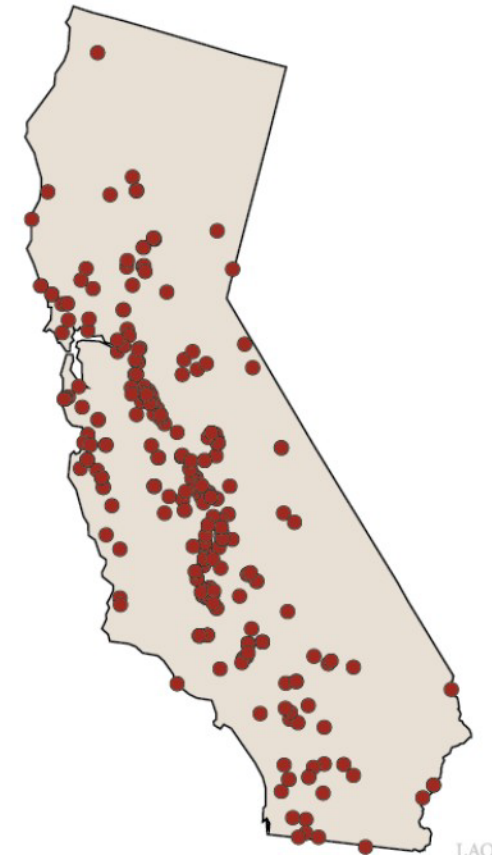
| YEAR | TOTAL NUMBER OF FAILING WATER SYSTEMS |
|------|---------------------------------------|
| 2017 | 308 |
| 2018 | 386 |
| 2019 | 368 |
| 2020 | 337 |
| 2021 | 418 |

Source: State law and State Water Board data on failing water systems.

<http://auditor.ca.gov/reports/2021-118/index.html#QL1>

Public Water Systems That Fail to Comply With Drinking Water Standards

As of September 2020



G, Petek, *Expanding Access to Safe and Affordable Drinking Water in California: A Status Update*, A Legislative Analyst's Report November 2020.

Can failure be predicted?

- Small water systems have a smaller rate-payer base.
- The smaller a system's base, the less able it is to afford water quality upgrades or to pay infrastructure costs needed to consolidate with other systems in region.
- These face the largest struggles in delivering safe, affordable drinking water.
- Even if small systems qualify for one-time grants for upgrades, they often lack sufficient technical, managerial, and financial resources to operate and maintain systems on an ongoing basis.¹

(1) In 2019, for example, the SWRCB found that over 91 percent of systems that failed to comply with water quality standards contained fewer than 500 service connections (Petek, 2020).

Local Area Formation Commissions (LAFCos)

- LAFCos regulate boundaries of special districts, determine if companies comply with *Safe Drinking Water Act*, and may disapprove annexations to a city or special district of territories served by mutual water companies (AB 54 – 2011).¹
 - Urban suppliers providing > 3,000 acre-feet of water/year must ensure a level of reliability in service sufficient to meet customer needs during normal & dry years (Corteze-Knox-Hertzberg (CKH) Act of 2000).
 - If consolidation sought, consideration must be paid to ensuring that water district boundary changes do not cause equity conflicts (e.g., rate-payer burdens).
 - *LAFCOs, under CKH, are “well positioned to . . . act intelligently on annexations, extensions of service, detachments, formations and other organizational changes pertinent to ESJ – however, legislative reforms needed to ensure interventions.*¹

(1) Marsha Burch, *Water Rights: Supply Issues for Local Agency Formation Commissions*, presentation at CALAFCO Annual Conference, Monterey, 2005. Also, Senate Bill 162 (2007) requires LAFCOs to consider environmental justice anytime a change of organization or reorganization is proposed.

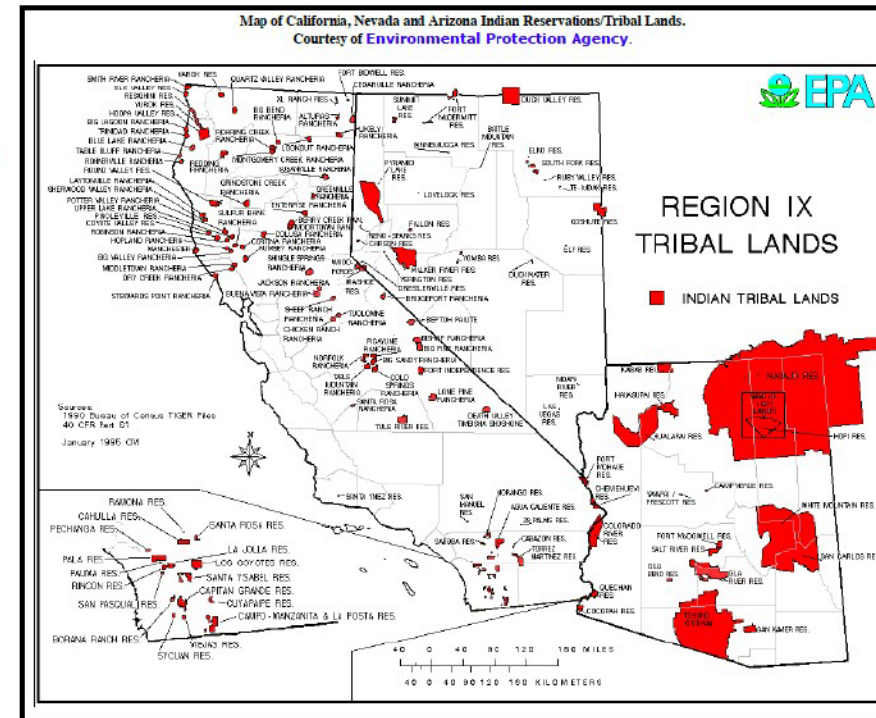
Instructive LAFCo actions

- 2018 - *Butte County LAFCo review of Oroville Region Water Service Study* requested by city council - compared Cal Water's costs and operations with those of South Feather Water and Power Agency and Thermalito Water and Sewer District.
 - CONCLUSION: Cal Water's Oroville service area is "well managed and well operated." Further, "the actual costs to produce and deliver water into the [South Feather] system are very similar to the actual costs for Cal Water to produce and deliver water into [its] system."
- 2020 – *LAFCo Analysis of proposals by Fallbrook and Rainbow water districts to leave San Diego County Water Authority and annex into Eastern Municipal Water District in Riverside County* would *increase costs for water ratepayers* in San Diego County; *reduce county's voting power*; *decrease water supply reliability* for farms and residents.
 - CONCLUSION: Until these concerns are addressed; LAFCO will not endorse annexation proposal.

Sources: <https://www.calwater.com/2018-0608-lafco-study-confirms-cal-water-well-managed/> -- and <https://www.sdcwa.org/member-agencies/lafco-reorganization>

Tribal Issues – legacies

- Displacement of tribes by settlers who sanctioned diverting water from streams for farming, livestock, domestic needs hastened legacy of exclusion.
 - Between 1851-1892, 18 treaties were negotiated between federal government and various tribes that compelled relinquishing traditional lands in exchange for reservations & promise of water.
- Tribal water systems are public systems located on tribal land serving a federally recognized tribe – regulated under tribal sovereign authority in partnership with U.S. EPA – *not* the state.
- Today, SWRCB & *Department of Water Resources* prescribe consultation & coordination methods for tribal nations – appropriate for CPUC.



Sources: Norris Hundley, Jr. (2001). *The Great Thirst – Californians and Water: A History*. Berkeley: University of California, pp. 66, 88-9; and Robert Glass Cleland (1941). *The Cattle on a Thousand Hills*. San Marino: Huntington Library, pp. 42ff.

Enhancing Tribal Consultation

- Use multiple sources to identify tribes impacted by cultural and historical issues *pertinent* to consolidation & acquisition.
- Confer with tribal-designated leaders to assess potential problems.
- Solicit relevant information from tribal nations on ESJ issues, especially given that tribal lands *contain many failed or threatened systems*.
- Draw on *tribal ecological knowledge* about impacts of consolidation and acquisition.
- Help preserve tribal rights and provide for sustainable management of California's sacred waters – *these may be threatened by acquisition & consolidation*.
- Explicitly acknowledge that tribal concerns are distinctive issues with regards to acquisition & consolidation.¹

⁽¹⁾ Executive Order B-10-11: Recognizes and reaffirms inherent right of Native American Tribes to exercise sovereign authority over their members and territories, establishes the *Governor's Tribal Advisor* position, reaffirms the state's commitment to working with Tribes, and encourages communication and consultation with Tribes. Sources: <https://water.ca.gov/about/tribal-policy> and https://www.waterboards.ca.gov/about_us/public_participation/tribal_affairs/

Increasing diversity and representation

- Support recruitment of under-represented groups to serve on water agency boards, other governance bodies.
 - Programs to recruit, train, fund electoral campaigns of under-represented groups could help alter the political landscape by which crucial water decisions are made.
 - *Association of California Water Agencies* has initiated a working committee to foster greater diversity and in the water workforce and among organizational leadership.
 - Other, minority-focused groups, have been actively pursuing this e.g., *Water Education for Latino Leaders (WELL)* and *African American Water Education Foundation*.

Sources: <https://latinosforwater.org> and <https://www.caawef.org>

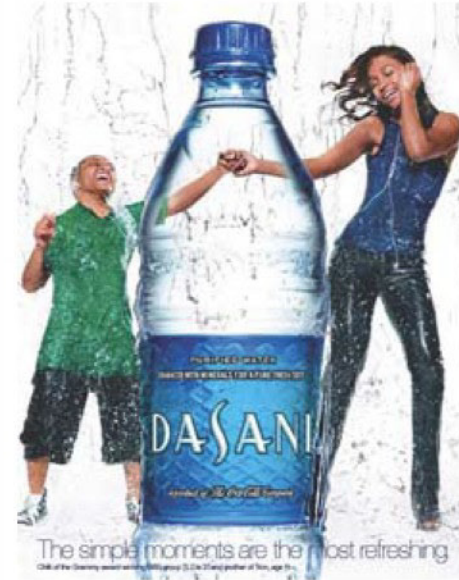
Affordability as justice challenge

- Minority and under-represented communities in California face special challenges *with regards to debt financing and overall rate-setting decisions.*
 - SWRCB estimates that 21% of state's water systems, serving 18% of residents, have water rates unaffordable for basic needs (e.g., cooking, washing, drinking).¹
 - Some 34% of all households earning less than 200% of the federal poverty level are potentially in need of rate assistance.
- Population base in small systems + low average incomes leads to insufficient revenue, limits staffs' ability to conduct necessary upgrade studies or acquire expertise to complete funding applications.
- One issue – in unsafe, sub-standard systems, high use of bottled water is a common practice. *This usage has several ESJ implications.*

(1) Caitrin Chappelle and Ellen Hanak (2021). *Water Affordability in California, Fact Sheet*, May. San Francisco, CA: Public Policy Institute of California - <https://www.ppic.org/wp-content/uploads/water-affordability.pdf>

Bottled water and minority populations

- In California, 55% of Latinos; 30% of whites drink bottled water as regular source of drinking water.
- Average cost of 60 gal of tap water in U.S. = 13.5 cents, while average cost of 60 gal of bottled water = \$48.
- Nationally, Latino households spend \$2.17 more a month on bottled water than non-Latinos, yet their median income is 24% below national average.
- Many recent immigrants to U.S. *distrust* tap-water – *marketing strategies by vendors often* exploit differences in beliefs & perceptions about water.



SOURCES: Viscusi et al 2014;; Archives of Pediatric and Adolescent Medicine (2011).



Bottled water and public health

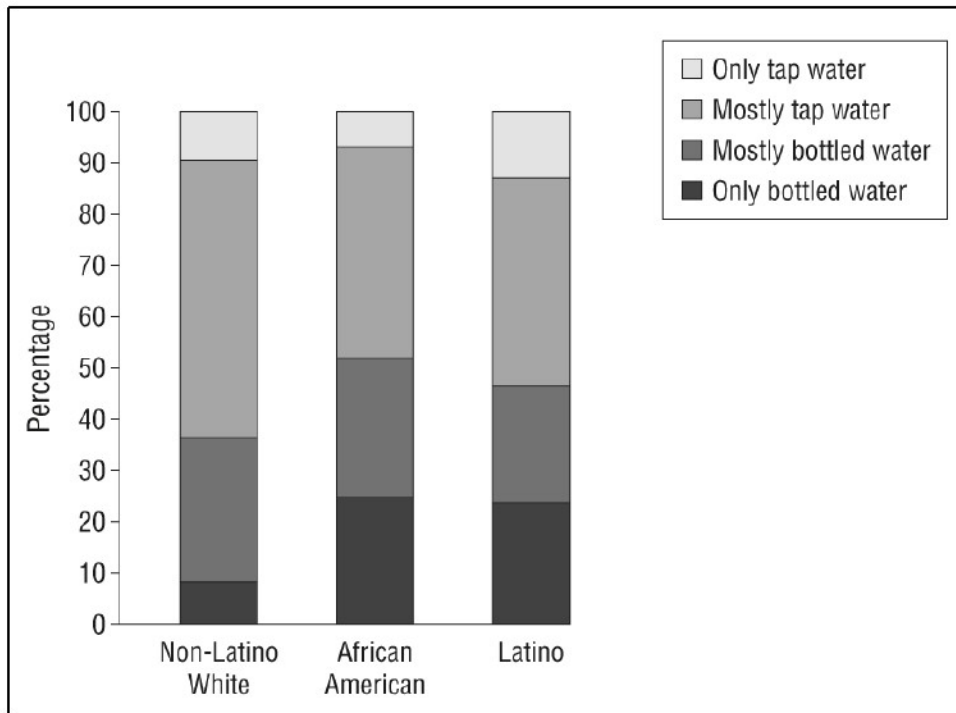


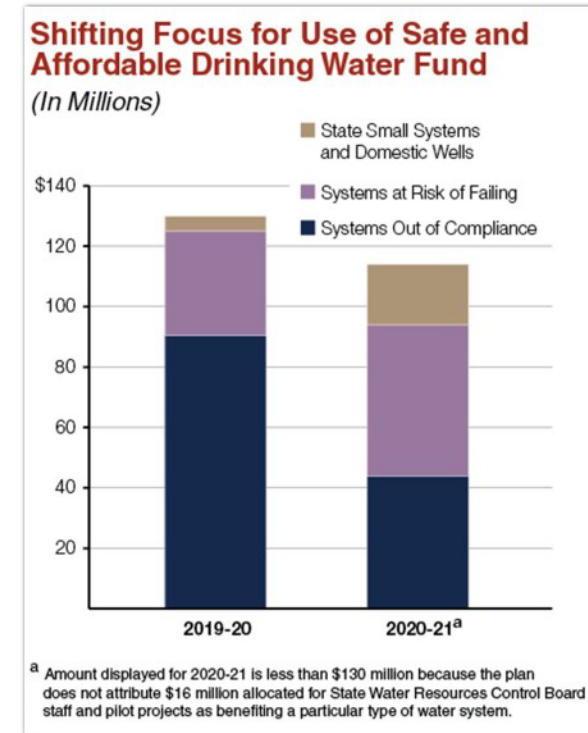
Figure 1. Bottled water use by racial/ethnic category.

- *Underserved Latinos & African American* children are 3x more likely to drink bottled water than whites.
- Under-represented groups are more likely to exclusively give bottled water to their children.
- Studies show elevated bacterial counts in bottled water, and an *association between bottled water use and risk of acute diarrheal illness* in children.
- Use of bottled water in place of tap water may lead to *inadequate fluoride intake* for children – with implications for oral health. ¹

(1) Gorelick MH, Gould L, Nimmer M, Wagner D, Heath M, Bashir H, Brousseau DC. "Perceptions about water and increased use of bottled water in minority children," *Arch Pediatr Adolesc Med.* 2011 Oct; 165(10):928-32. doi: 10.1001/archpediatrics.2011.83.

Innovative funding solutions

- Various financing options are available to assist low-income communities with failed or near-failing systems. Issues germane to CPUC include:
 - *Safe and Affordable Funding for Equity and Resilience (SAFER) and Safe Drinking Water Fund (SADW) (SB200)* – 2019: goals are to “help water systems provide an adequate and affordable supply of safe drinking water in both the near and long terms.”¹
 - SAFER pairs funds from SADW with other sources.
 - Funds can be used for:
 - Operations and Maintenance
 - *System Consolidations*
 - Emergency Water Supplies
 - Appointed Administrators
 - Long-Term Solutions
 - Administrative Costs

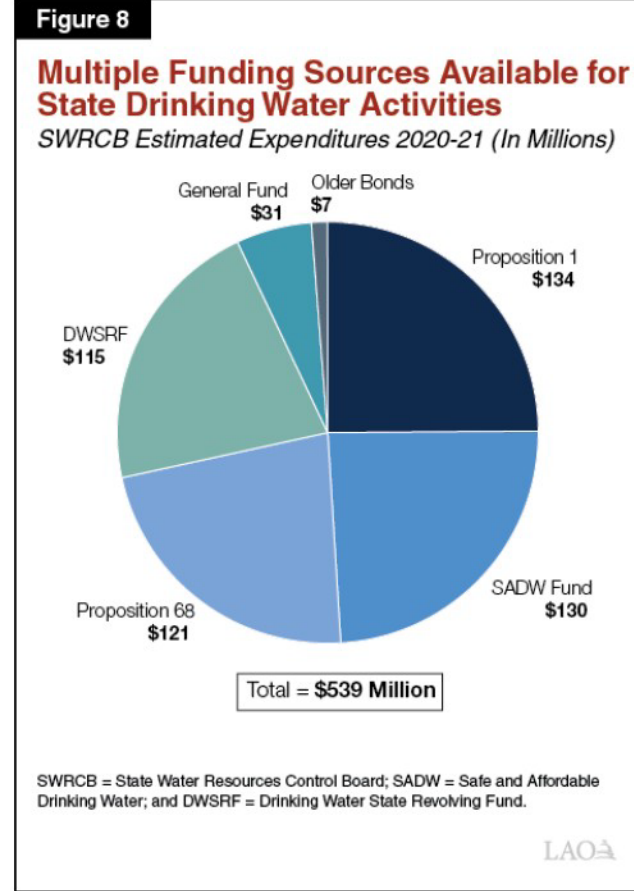


(1) G, Petek, *Expanding Access to Safe and Affordable Drinking Water in California: A Status Update*, A Legislative Analyst's Report November 2020.

Other funding equity issues

- *Drinking Water State Revolving Funds (SRFs)*: prioritized for projects that address serious human health risks, compliance with *Safe Drinking Water Act* requirements, and to assist public water systems in small disadvantaged communities.
- *Debt financing*: larger public water utilities have legal authority to issue debt, and the almost guaranteed returns and tax-free nature of municipal bonds makes them attractive for certain investors.
 - Not as true for smaller agencies needing to raise large amounts of capital, yet reluctant to “rate shock” their consumers.¹

(1) Tap into Resilience: Pathways for Localized Water Infrastructure – Executive Summary, UCI Law Center for Land, Environment, and Natural Resources and Water Now Alliance (2019). <https://tapin.waternow.org/resources/executive-summary-pathways-for-localized-water-infrastructure>.



Summary – educating customers on involvement and engagement

- Continue collaborating with groups dedicated to recruitment of minorities on local water agency boards.
- Monitor and encourage efforts by local agencies in under-represented communities to utilize LAFCos as means of achieving ESJ objectives
- Engage with communities exploring options such as SB200 to understand processes and procedures for effective access and to ensure funding equity.
- Be mindful of vulnerable systems' resource, staff, training, and technical expertise needs and shortcomings when entering into acquisition/consolidation decisions.
- Explicitly incorporate *tribal concerns* over health, safety and welfare into acquisition & consolidation cases; enhance intergovernmental cooperation between tribes and neighboring water agencies; provide technical assistance grants targeted to failed systems on tribal lands.*

* See: <https://www.cpuc.ca.gov/about-cpuc/divisions/office-of-the-tribal-advisor/tribal-consultation-policy>

Morning Break

10 mins

Morning Questions

Time: 75 mins

Questions

Morning Session

1. How should ratepayer impacts be examined when reviewing an acquisition?
2. How could analysis of ratepayer impacts be standardized or become more consistent in acquisitions?
3. How important is the ratepayer impact on existing customers of the acquiring utility?
4. How should the benefits and costs of acquisitions be quantified?
5. How should rate impacts from previous acquisitions be assessed when reviewing a proposed acquisition?

Morning Discussion

Ground Rules

- Use raise hand feature on Webex to request to speak
 - Moderators will unmute party representatives on their turn
- Party representatives have 1 minute to speak
 - Timer will start when speech begins



Reminder: Parties will have the opportunity after the workshop to provide additional written comments to the Water Division's workshop report

Public Comment

- Please use the “**Raise Hand**” feature in Webex window to request to speak



- **1 minute** is allotted for each speaker
 - Timer will start when speech begins

Lunch Break

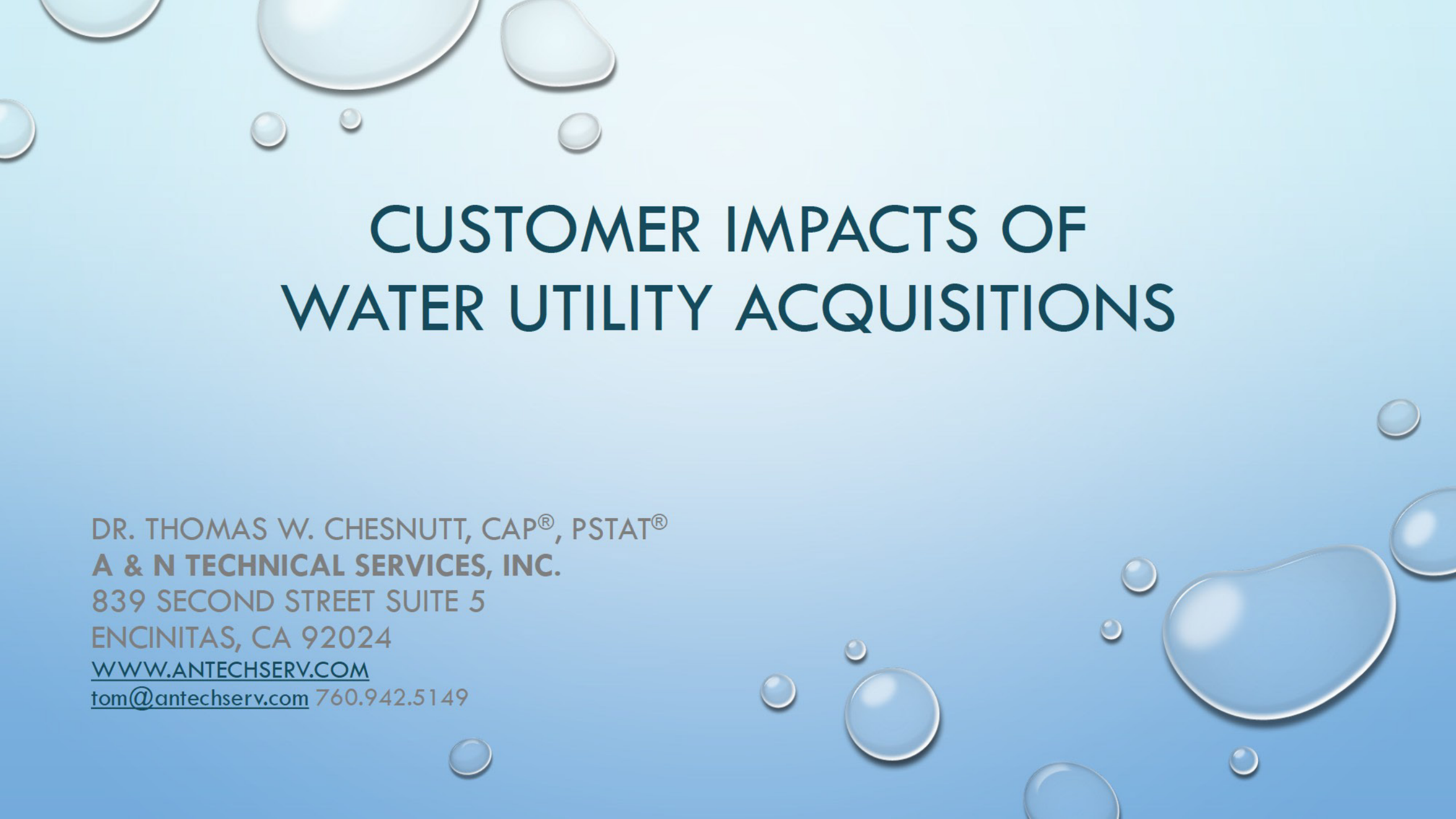
60 mins

Afternoon Session

Case Studies

Ratepayer Impacts

Time: 30 mins



CUSTOMER IMPACTS OF WATER UTILITY ACQUISITIONS

DR. THOMAS W. CHESNUTT, CAP[®], PSTAT[®]

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I WILL SPEAK TO THE FIRST 3 QUESTIONS


QUESTIONS

ANSWERS

1. How should the Commission examine **ratepayer impacts** when reviewing water utility acquisitions? What tests and criteria should be used, if any?
2. Should **the impacts on existing customers** of the acquiring water utility be included in the review of ratepayer impacts?
3. How should the Commission measure the **benefits and costs of water utility acquisitions**?
4. Should rate impacts from previous acquisitions be assessed when reviewing a proposed water utility acquisition?
5. Should the Commission consider expanding the gain on sale rules?
6. Should the Commission consider cost-sharing mechanisms between ratepayers and shareholders for water utility acquisitions?



My Focus

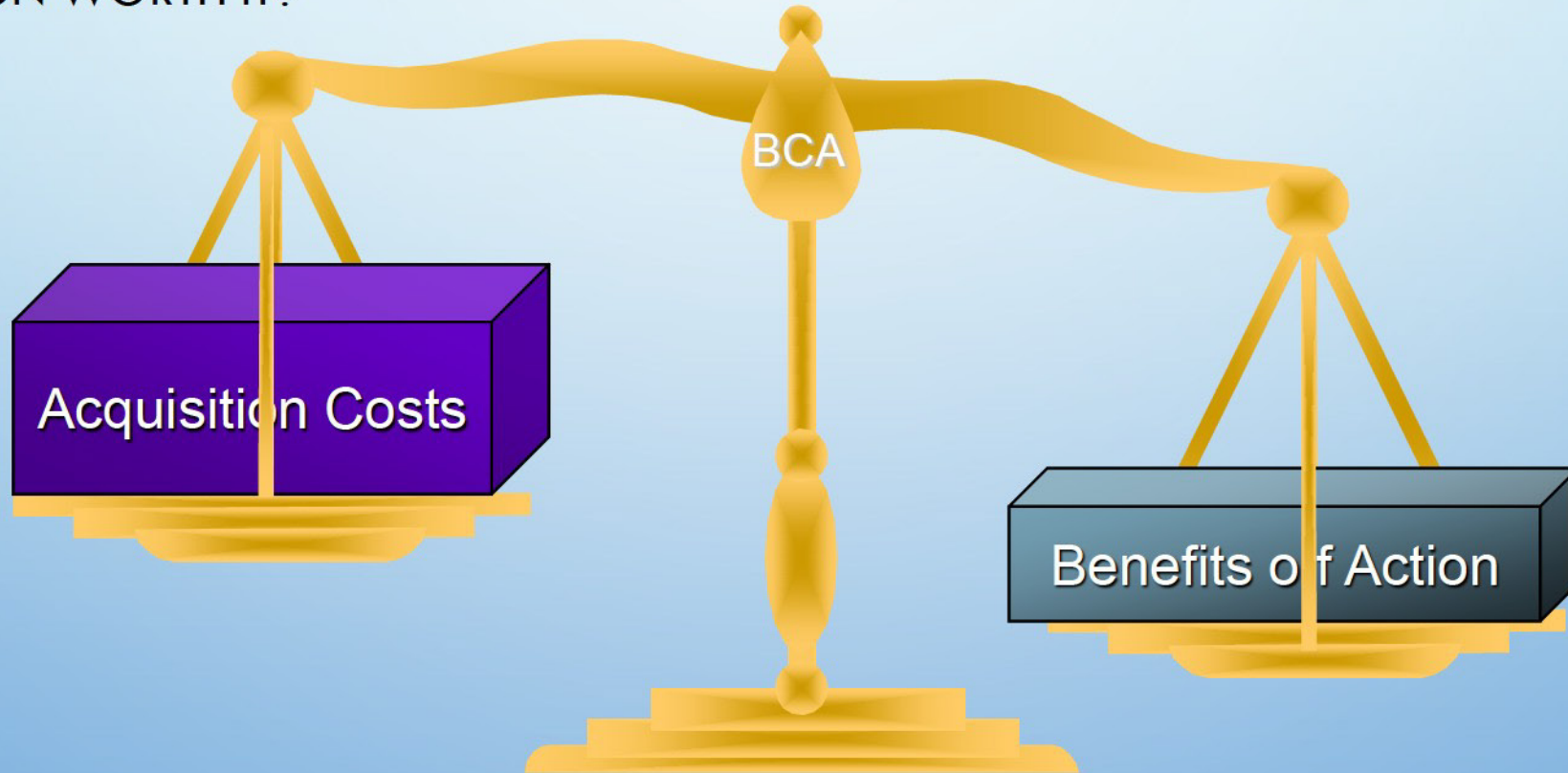


Some Thoughts

Note: Regulatory Reform is hard, especially if the reform is an improvement
Grounding Reform in reality improves your odds.

WHAT ARE BENEFITS AND COSTS OF ACQUISITIONS?

- IS ACQUISITION WORTH IT?



THE PROBLEM

- SYSTEMS BEING ACQUIRED, HAVE LOS ISSUES
 - IMPERFECT BILLING SYSTEM DATA
 - COLLECTION ACCOUNTS
 - POOR ASSET MANAGEMENT
 - DEFERRED RENEWAL AND REPLACEMENT
 - NO WATER LOSS CONTROL PROGRAM
 - LITTLE OBSERVABLE WATER USE EFFICIENCY
 - LOW CUSTOMER OUTREACH
 - INEFFICIENT STAFFING
 - IMPERFECT REGULATORY COMPLIANCE, ETC.
- FACT: DUE DILIGENCE CANNOT ATTAIN CERTAINTY

BUZZWORD BINGO: LOS

ESTABLISHING LEVELS OF SERVICE: A DEFINITION

Levels of service (LoS) can have different interpretations. Common views include that they are

- regulatory measures mandated at the federal, state, and local government levels or public-facing commitments and agreements;
- codes, standards, policies, and guidelines; and/ or
- performance measures and key performance indicators.

AWWA defines LoS as a statement of outputs or objectives that water utilities or their activities intend to deliver to customers and stakeholders. "Objectives" can also be thought of as outcomes.

ISO 55000* further defines LoS as parameters that reflect social, political, environmental, and economic outcomes that the organization delivers. Parameters can include

- safety,
- customer satisfaction,
- quality,
- quantity,
- capacity,
- reliability,
- responsiveness,
- environmental acceptability,
- cost, and
- availability.

The *International Infrastructure Management Manual (IIMM)*, published by the Institute of Public Works Engineering Australasia (2020), adds that LoS are key in asset management decision-making and provides the platform for all lifecycle decision-making.

*International Organization for Standardization. ISO 55000:2014, *Asset Management—Overview, Principles and Terminology*.

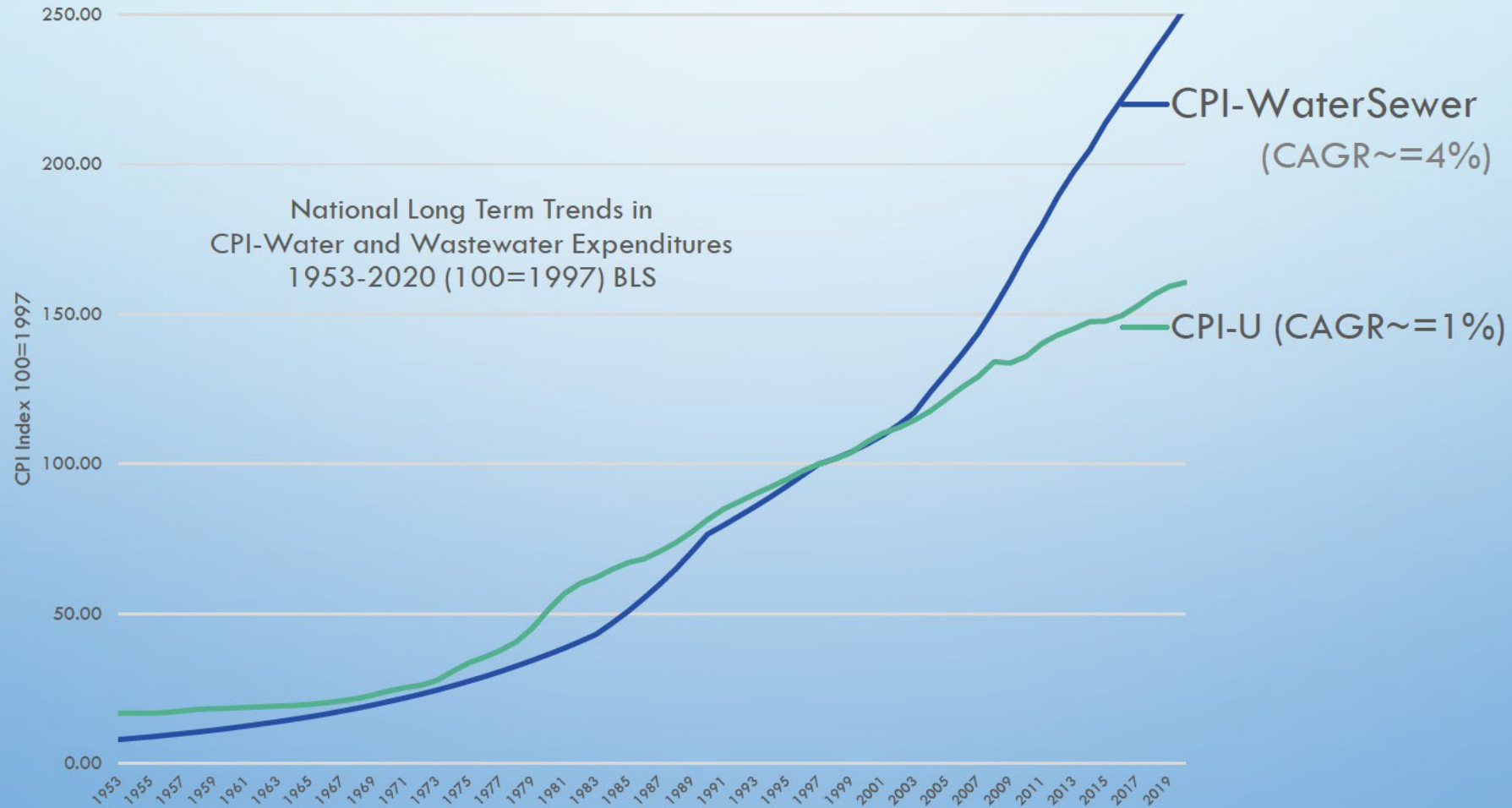
CUSTOMER COSTS AND BENEFITS

Costs are direct, obvious, easy to measure, more certainty

Benefits are diffuse, difficult to measure, more uncertainty

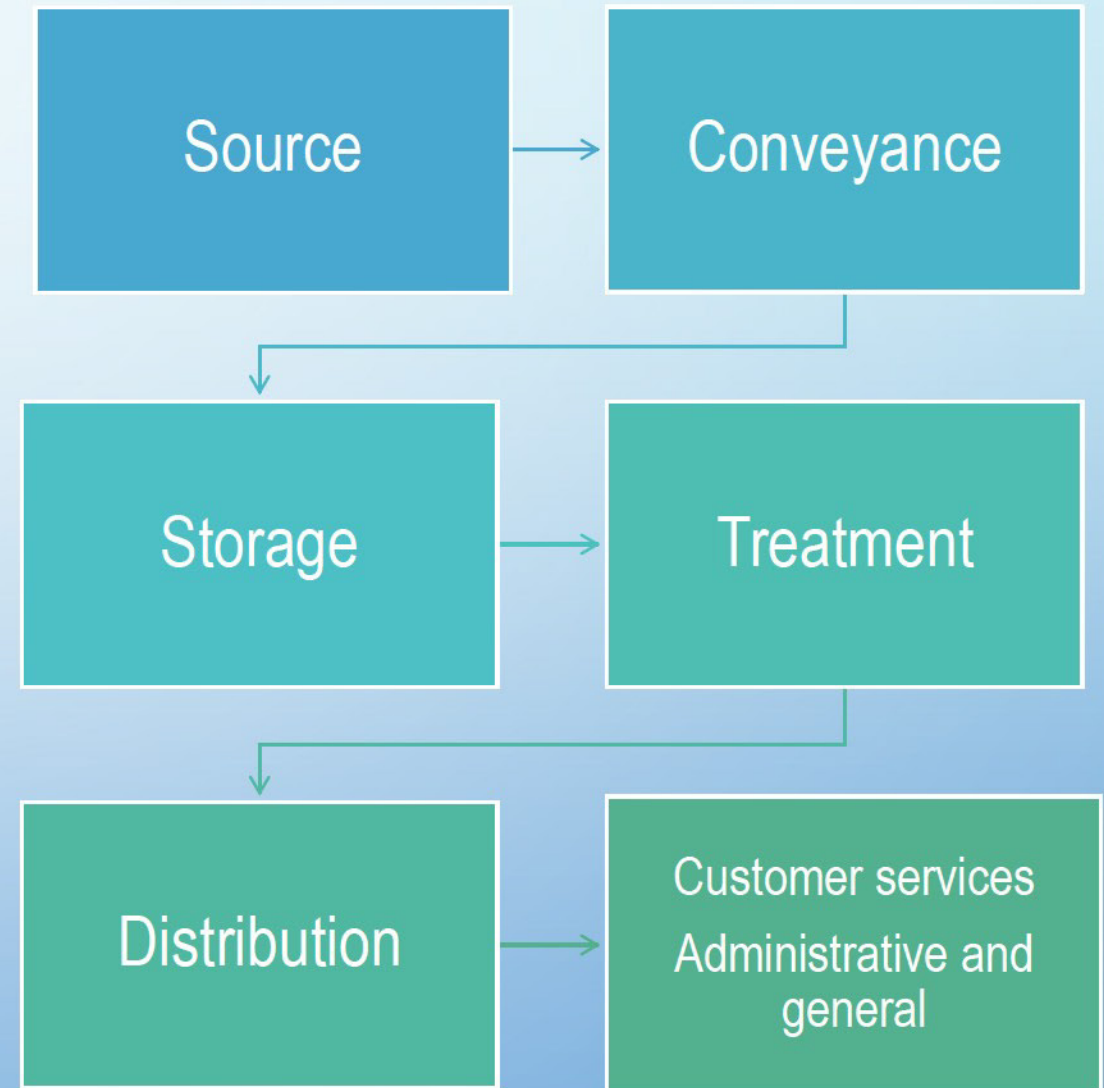


COST OF WATER SERVICE HAS EXCEEDED GENERAL INFLATION BY A FACTOR OF MORE THAN 3 SINCE THE YEAR 2000





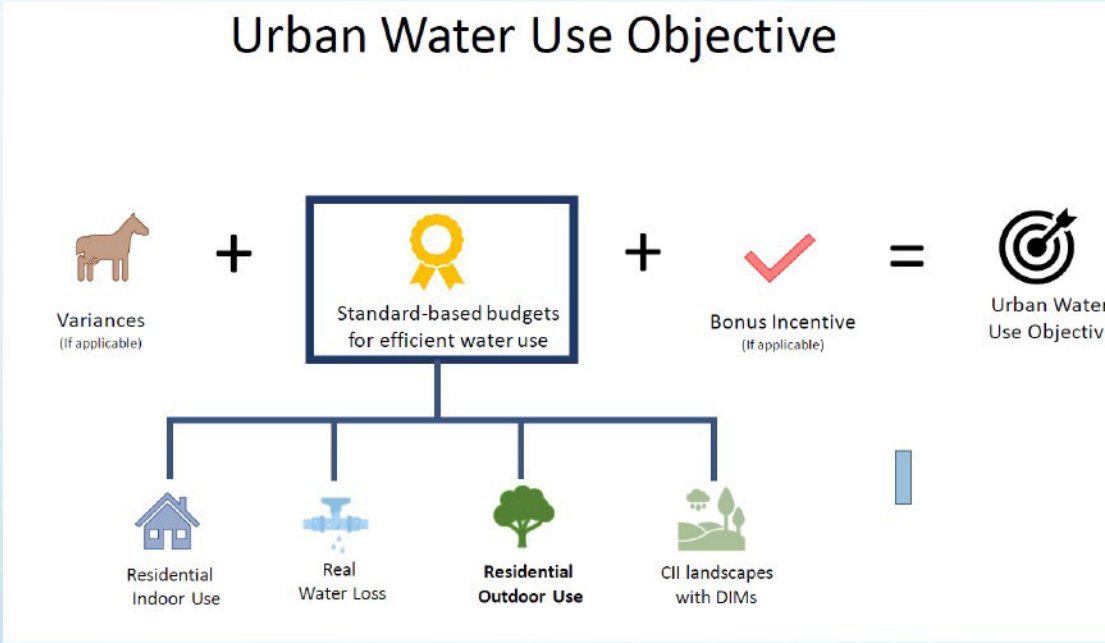
WATER UTILITY COST DRIVERS

- LIMITS AND THREATS TO EXISTING SOURCES
- DEFERRED CONVEYANCE R&R
- WATER QUALITY THREATS DRIVING TREATMENT COSTS
- DISTRIBUTION REPLACEMENT
- CUSTOMER SERVICE EXPECTATIONS
- REGULATORY COMPLIANCE COSTS W/I CALIFORNIA



COST DRIVERS – DID SOMEONE SAY CALIFORNIA?

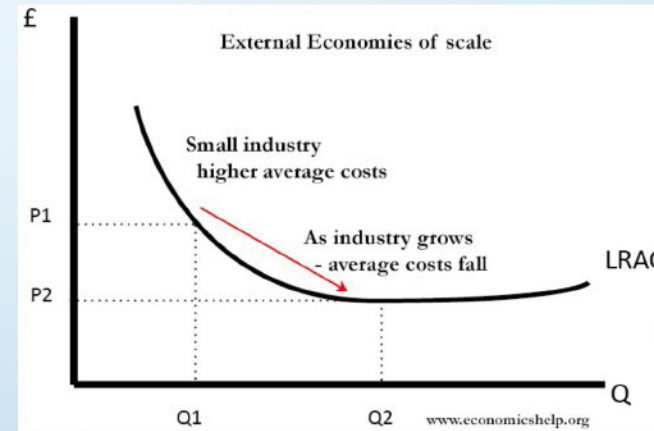
| Chapter Section and Title where Item is Addressed | Executive Order Items | | | | | | | | | | | | | Within Existing Authorities (Chapter 2) | Requires New Authority (Chapter 3) |
|---|--|---|---|--|---|---|--|---|---|--|----|----|----|---|------------------------------------|
| |  Use Water More Wisely | | |  Eliminate Water Waste | | |  Strengthen Local Drought Resilience | | |  Improve Agricultural Water Use Efficiency & Drought Planning | | | | | |
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | | |
| 2.1 Emergency Water Conservation Regulations for 2017 | ● | | | | | | | | | | | | | ✓ | |
| 2.2 Permanent Prohibition of Wasteful Practices | | | ● | ● | | | | | | | | | | ✓ | |
| 2.3 Reduced Water Supplier Leaks and Water Losses | | | | | ● | ● | | | | | | | | ✓ | |
| 2.4 Certification of Innovative | | | | | | | | | | | | | | ✓ | |
| Making Water Conservation a California Way of Life | | | | | | | | | | | | | | | |
| Implementing Executive Order B-37-16 | | | | | | | | | | | | | | | |
| 3.2 Water Shortage Contingency Plans | | | | | | ● | | ● | ● | | | | | ✓ | |
| 3.3 Drought Planning | | | | | | | | | | ● | | | | | ✓ |



ECONOMIES OF SCALE AND SCOPE

- ECONOMIES OF SCALE – LOWER AVERAGE COST WITH SCALE

(MY IDEA OF A CARTOON)



- ECONOMIES OF SCOPE – LOWER TOTAL COSTS ACROSS MULTIPLE SERVICES
 - ONE WATER SERVICES: POTABLE WATER, RECYCLED WATER, WASTEWATER, WATER EFFICIENCY (WUE AND WATER LOSS), AND STORMWATER

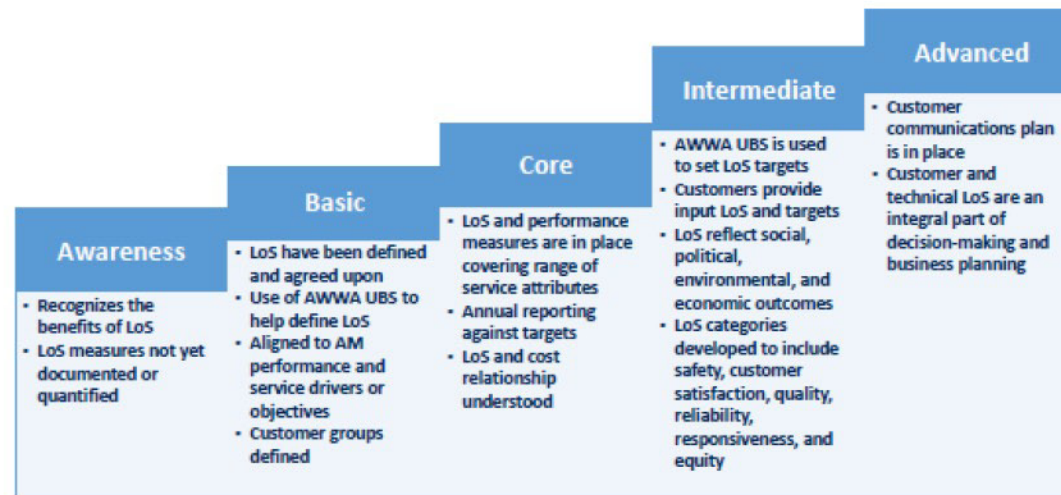
ONE WATER – WATER RESEARCH FOUNDATION

- SYNERGIES THROUGH OUT ONE WATER SERVICES

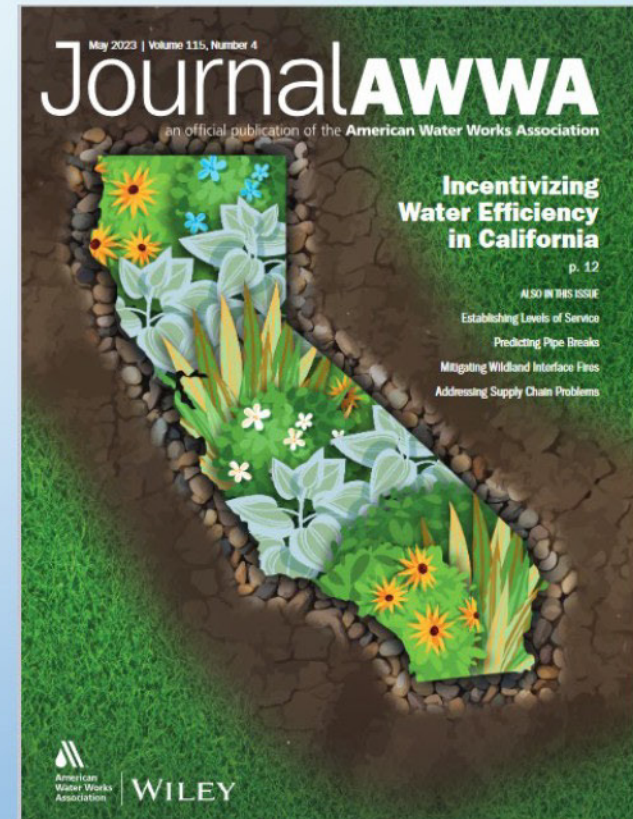
[HTTPS://WWW.WATERRF.ORG/RESEARCH/PROJECTS/BLEUPRINT-ONE-WATER](https://www.waterrf.org/research/projects/blueprint-one-water)

LEVELS OF WATER SERVICE

LoS Maturity Scale



AM—asset management, LoS—levels of service, UBS—Utility Benchmarking Survey

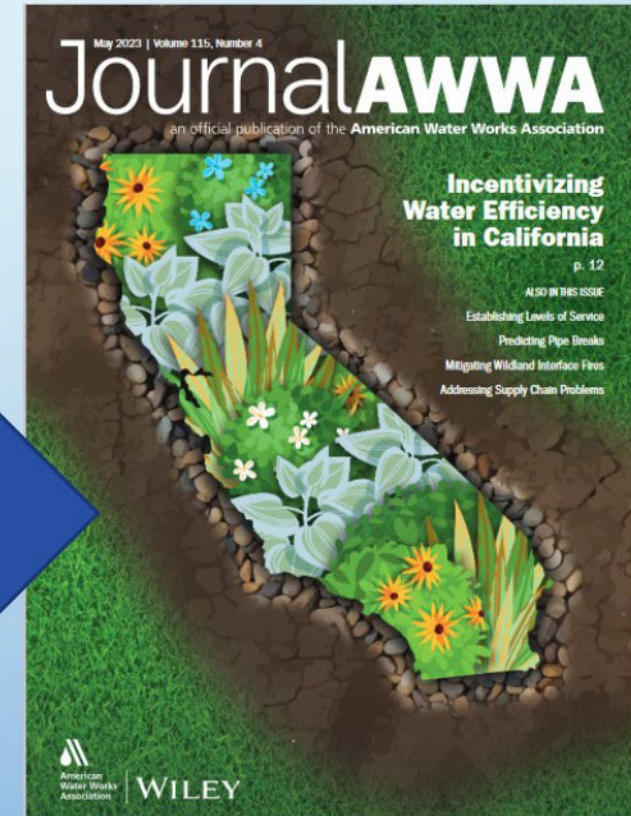


<https://doi.org/10.1002/awwa.2088>

A DIGITAL TWINS (aka A CASE STUDY)

- **UTILITY B – BEING ACQUIRED**
 - A PUBLIC UTILITY
 - AN “INTERESTING” POLITICAL HISTORY
 - HISTORY OF RATE LITIGATION – BUZZWORD BINGO “LAWFARE”
 - 8 YEARS OF CONSTANT RATES → DEFERRED COSTS
- **UTILITY A – ACQUIRING UTILITY**
 - ALSO PUBLIC
 - OPERATIONAL SYNERGIES
 - ADDRESSABLE WASTEWATER INFRASTRUCTURE DEFICIENCIES
 - FIXABLE RATE STRUCTURE (WITH TRANSITION PERIOD)
 - COMPLEMENTARY SUPPLY PORTFOLIO

You are Here



“Keep the Mayor out of the water department”

<https://doi.org/10.1002/awwa.2066>

SOME STATISTICS GOING INTO ACQUISITION

Utility B – Being Acquired

Utility A – Acquiring

Services and Service Area

| | | |
|-------------------|-------------|--------------|
| Population | 36,262 | 165,000 |
| Voters | 18,402 | 88,331 |
| Service Area | 14.4 sq.mi. | 97.9 sq.mi. |
| Assessed Value | \$7.2 bill. | \$18.1 bill. |
| Utility Employees | 19.8 | 69.5 |
| Total Employees | 26.0 | 144.0 |

Governance

| | | |
|----------------|------------------------------------|--------------------------|
| Governing Body | 5 City Council members by district | 5 Board Members at large |
|----------------|------------------------------------|--------------------------|

| | | |
|-------------------------------|----------|-----------|
| Domestic+Recycled Water (mgd) | 5.7 mgd | 26.4 mgd |
| Acre Feet per Year | 6,396 AF | 29,617 AF |
| % Imported | 64% | 78% |

Wastewater

| | | |
|-------------------|-----------|-----------|
| Collection System | 120 miles | 630 miles |
|-------------------|-----------|-----------|

Total \$16.0'mill.

Capital Expenditures

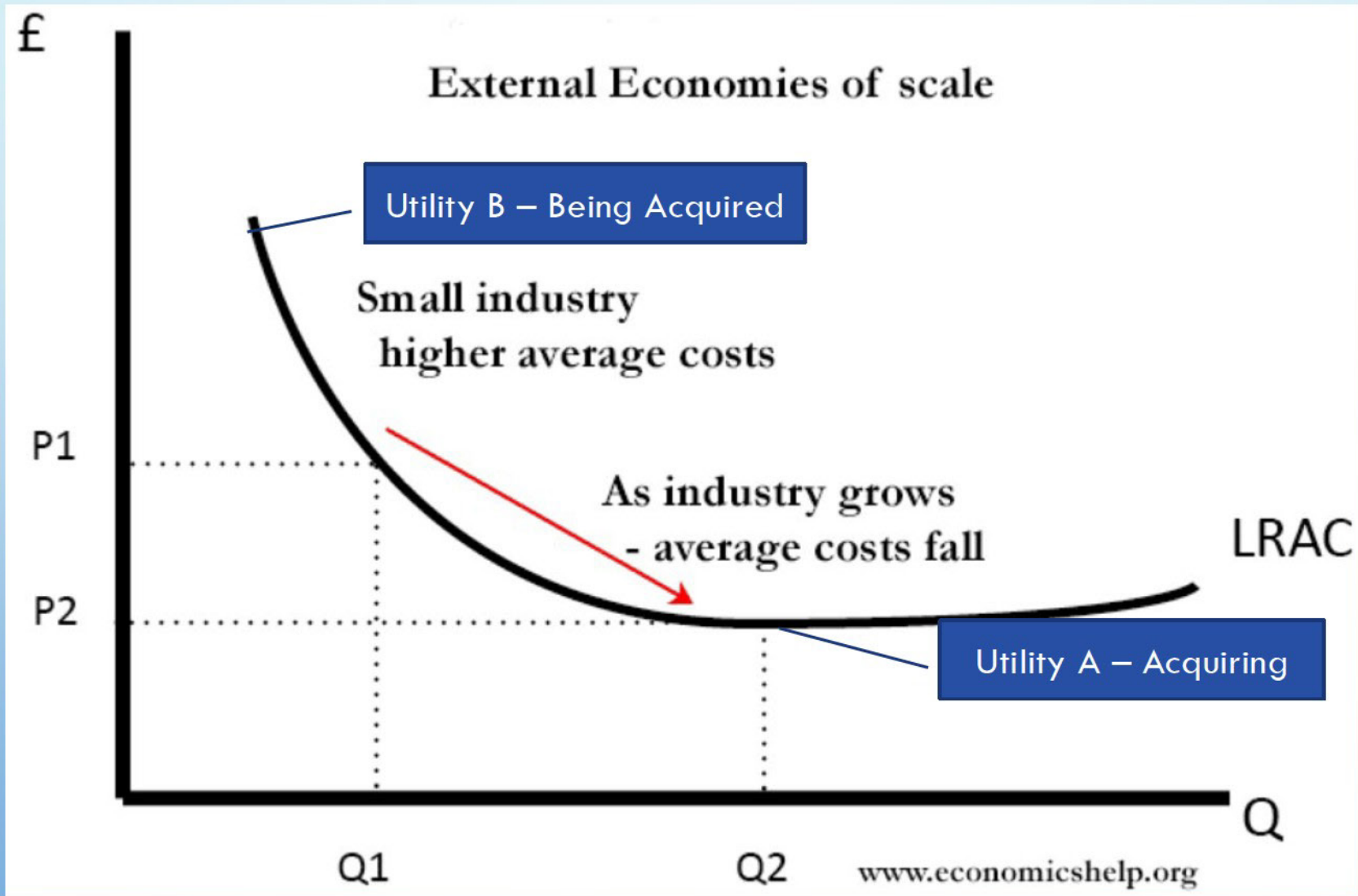
CIP Annual Average \$3.2 mill.

Full-Cost Pricing

AWWA holds that the public can best be provided water services by self-sustaining enterprises which are adequately financed with rates and charges based on sound accounting, engineering, financial, and economic principles. Revenues from service charges, user rates, and capital charges (e.g., impact fees, system development charges) should be sufficient to enable utilities to provide for the full cost of service, including the following:

- Annual O&M expenses
- Capital costs (e.g., debt service, other capital outlays)
- Adequate working capital and required reserves

Full-cost pricing—i.e., charging rates and fees that reflect the full cost of providing water and/or wastewater services—should include renewal and replacement costs for treatment, storage, distribution, and collection systems. Some utilities have previously kept their rates low by minimizing or ignoring renewal and replacement costs, but as the



OUTCOME EVIDENCE BASE— AFTER 1.5 YEARS OF OPERATING

- OPERATIONAL EFFICIENCY

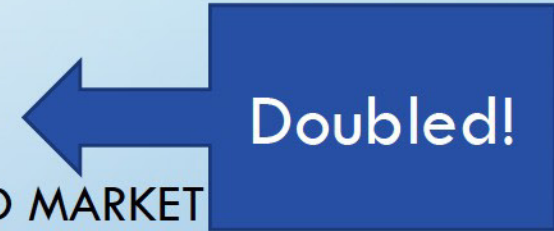
- ALMOST 20 % OF PRE-ACQUISITION OPERATIONAL EXPENSES (OPEX), ~3M\$/YR



3M\$!

- INFRASTRUCTURE RENEWAL AND REPLACEMENT

- CIP WILL MORE THAN DOUBLE
- FUNDED OUT OF OPEX EFFICIENCIES, NO IMMEDIATE NEED TO GO TO BOND MARKET



Doubled!

- AVERAGE BILL CHANGE LIMITED TO LESS THAN 5% IN TRANSITION PERIOD, %7 THEREAFTER

- HIGHER LEVELS OF CUSTOMER SERVICE, WATER USE EFFICIENCY, AND WATER LOSS CONTROL

- SYNERGIES WITH WATER RESOURCE PORTFOLIO (GW AND RW)

FINDINGS

- EXPECT UNCERTAINTY: DUE DILIGENCE IS NOT CERTAINTY
 - MANY THINGS WILL BE DISCOVERED ONLY THROUGH **OPERATING**
- RECOMMEND **TRANSITION PERIOD** TO MITIGATE ANY CUSTOMER BILL IMPACTS—RATE RAMPS
- **SYNERGIES** CAN REASONABLY BE EXPECTED TO OCCUR
 - MANAGEMENT, STAFFING EFFICIENCIES, COMPLIANCE EFFICIENCIES—COMPANY CAPACITY BUILDING
 - IMPROVEMENTS TO LEVELS OF SERVICES
- RECOMMEND **GRADUATED** ACQUISITION INFORMATION REQUIREMENTS
 - IF UTILITY IS SMALL (<5K) , ESPECIALLY RELATIVE TO ACQUIRING COMPANY (<10% OF CONNECTIONS)

I WILL SPEAK TO THE FIRST 3 QUESTIONS

QUESTIONS

1. How should the Commission examine **ratepayer impacts** when reviewing water utility acquisitions? What tests and criteria should be used, if any?
2. Should **the impacts on existing customers** of the acquiring water utility be included in the review of ratepayer impacts?
3. How should the Commission measure the **benefits and costs of water utility acquisitions**?
4. Should rate impacts from previous acquisitions be assessed when reviewing a proposed water utility acquisition?
5. Should the Commission consider expanding the gain on sale rules?
6. Should the Commission consider cost-sharing mechanisms between ratepayers and shareholders for water utility acquisitions?

ANSWERS

A1. Yes

A2. Yes, Hold Harmless still stands

A3. Yes

A4. Hard No. (Context varies, Company varies, inferential hazards abound.) Done.

A5. Sounds like an accounting and practical nightmare that I will not speak to.

A6. Ditto.

CONCLUSION: CAPACITY BUILDING

Welcome to the Chance Age Webinar Series



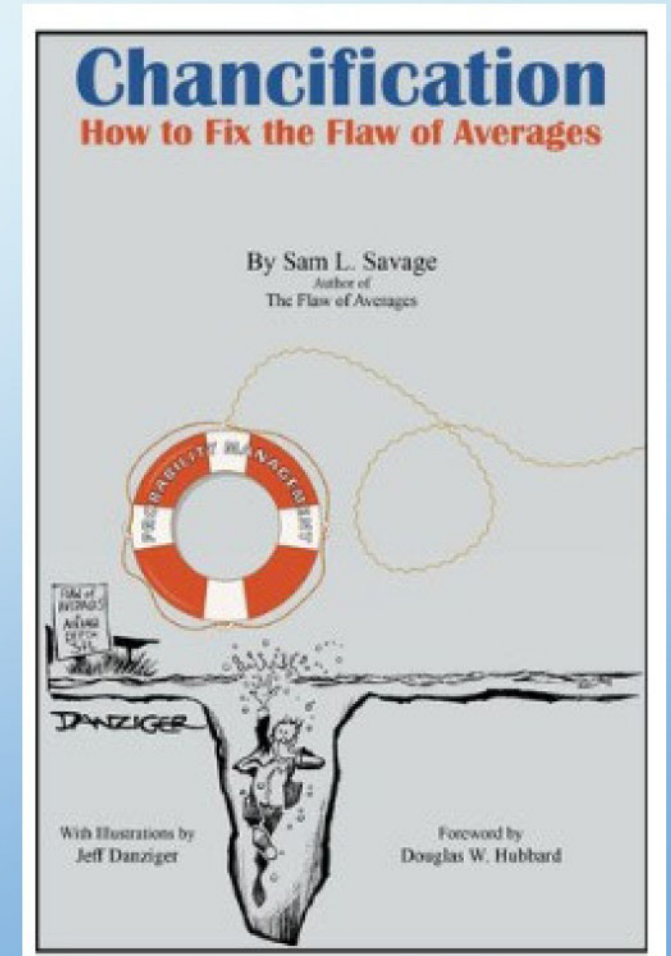
New Dates Added

June and July

Register Now

This highly interactive two part webinar series covers a variety of topics and attendees are encouraged to share their areas of interest for chance-informed applications. To learn more, visit the [Applications](#) page on our website.

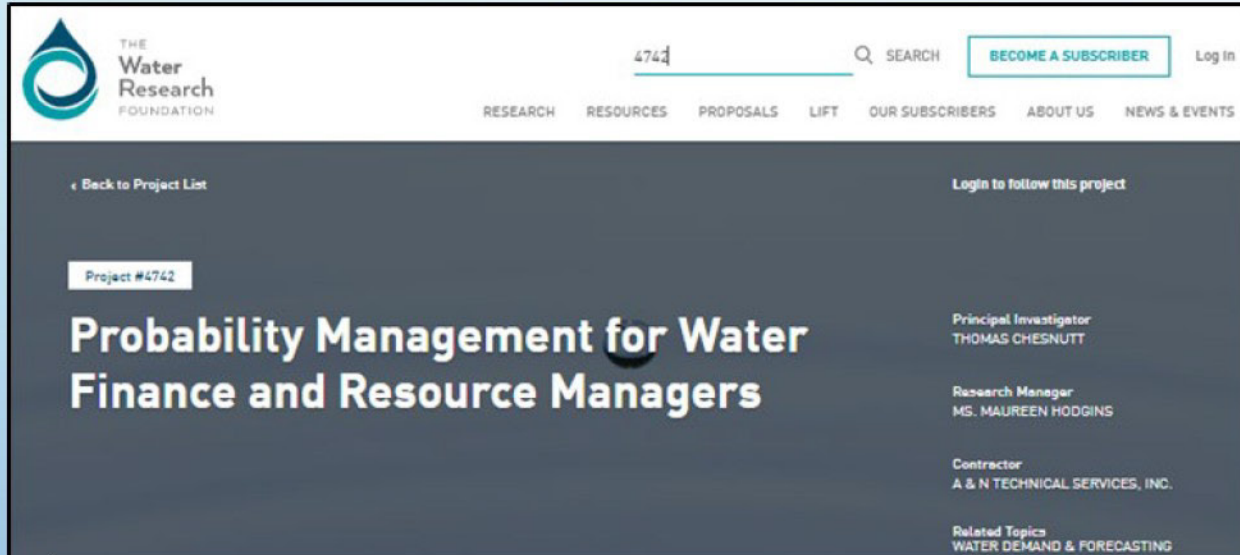
As a reminder, webinar attendees also receive a free copy of **ChanceCalc**, a free Kindle copy of Dr. Savage's book **Chancification: How to Fix the Flaw of Averages** (valid only for U.S.-based email addresses), and a discount for **ChanceCalc Monte Carlo**. In addition, attendees will be invited to the **SIPply Chain Forum**, a monthly web gathering to discuss the latest developments in SIP Library generation.



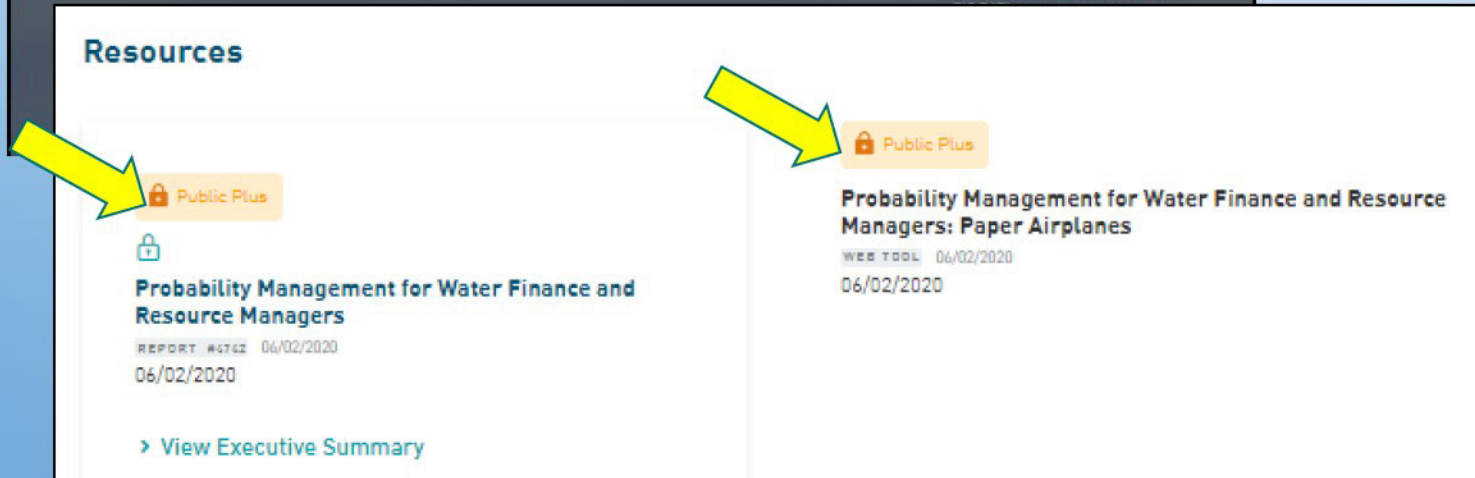
<https://www.probabilitymanagement.org/chancification-webinars>

SPEAKING OF UNCERTAINTY...MORE ASSISTANCE

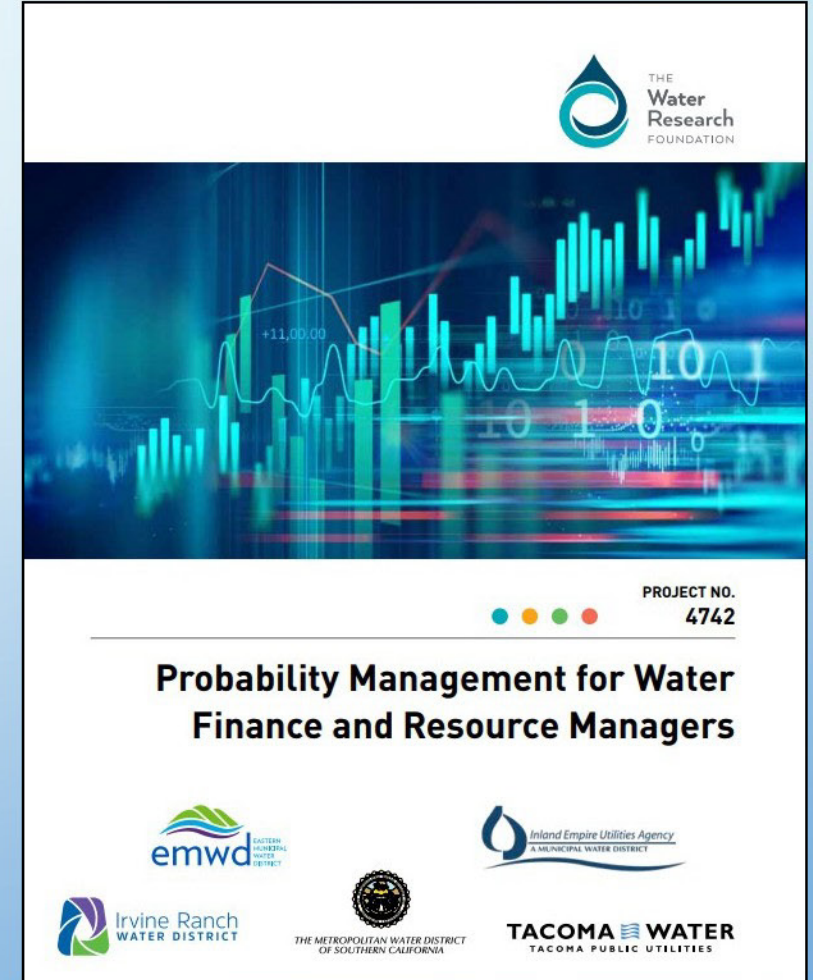
WWW.WATERRF.ORG, SEARCH 4742



The screenshot shows the top navigation bar of the Water Research Foundation website. The search bar contains the text "4742". Below the navigation bar, the project details for Project #4742 are displayed. The title is "Probability Management for Water Finance and Resource Managers". The Principal Investigator is Thomas Chesnutt, the Research Manager is Ms. Maureen Hodgins, and the Contractor is A & N Technical Services, Inc. The Related Topics are Water Demand & Forecasting.



The screenshot shows the Resources section of the Water Research Foundation website. There are two entries for Project #4742, both marked as "Public Plus" with a yellow arrow pointing to the lock icon. The first entry is titled "Probability Management for Water Finance and Resource Managers" and is a Report #4742 dated 06/02/2020. The second entry is titled "Probability Management for Water Finance and Resource Managers: Paper Airplanes" and is a Web Tool dated 06/02/2020. A yellow arrow points to the "Public Plus" lock icon on the second entry.



The screenshot shows the cover of the report for Project #4742. The title is "Probability Management for Water Finance and Resource Managers". The cover features a blue background with a stylized bar chart and line graph. The logos of the participating organizations are displayed at the bottom: emwd (Eastern Municipal Water District), Inland Empire Utilities Agency, Irvine Ranch Water District, The Metropolitan Water District of Southern California, and Tacoma Water (Tacoma Public Utilities).

CREATE A WEBSITE ACCOUNT: LOG IN, CREATE A FREE "PUBLIC PLUS" ACCOUNT

Ratepayer Impacts/Gain on Sale

Time: 30 mins



The Public
ADVOCATES
OFFICE

Acquisition Rulemaking 22-04-003

Workshop #3: Ratepayer Impacts

Eddie Scher, Cal Advocates
June 13, 2023

Revised Acquisition Framework

The revised acquisition framework should reassert the basic principals of ratemaking with guidelines that protect ratepayers and achieve public policy goals.

- Ratepayer Fairness
- No Windfall Profits
- Level the Playing Field – no longer facilitate acquisition of healthy systems with high premiums over failing systems
- Prioritize Failing Systems

Commission Standard for Review

Commission responsibility to ensure fair rates:¹

- (i) the resulting effect on existing customers of the acquiring utility *and* the acquired public water system is **fair and reasonable**,²
- (ii) ratepayers are **indifferent** to the effects of the acquisition.³

Ratepayers are not indifferent to unreasonable returns.

--

¹ PU Code § 451

² D.21-08-002, p. 11, *citing* § 2720(b).

³ D.21-08-002, p. 12. See also D.19-04-015, *Decision Authorizing Sale and Transfer*, p. 18

Ratepayer Fairness Comes First

“[W]hen a new rate base amount is unreasonable and unfair as a result of applying the new ‘fair market value’ standard . . . we retain authority to deny a merger.”

- D.21-08-002

Ratepayer's Perspective on Current Framework

Acquisitions can achieve public benefits by helping failing water systems.

Acquisitions can circumvent ratepayer fairness, transparency, and the ratemaking process.

- Sellers may realize windfall profits
- Ratepayers fund full return on acquisition price
- Ratepayers paid seller for utility assets, plus authorized rate of return
- With sale, ratepayers pay seller again for the same assets – *only more*

*IOUs competing to buy water systems through an RFP is NOT a market.
Ratepayers are on the hook for full cost and risk of ownership.*

Acquisition Growth Strategy

Business Mix

100%

Regulated and
Regulated-Like Earnings

*Military
Services
Group*

≈0.2%

Regulated
Acquisitions

1.5-2.5%

Regulated
Investment
CAPEX

5-7%

← Cal Am parent target -
25% of 2023 growth
through utility acquisitions

American Water 2022 Fourth Quarter & Year-End Earnings Conference Call [February 16, 2023](#)

Public Benefits Should be Defined and Documented

“While consolidation offers many potential benefits for communities served by unreliable water systems, the legal, institutional, financial, and political costs, benefits, information gaps, and best practices associated with consolidations have not been well documented.”

- Wheeler Water Institute, UC Berkeley Center for Law, Energy, & the Environment
Learning from CA's Experience with Small System Consolidation
[2018 Workshop Synthesis](#), page 1

Ratepayer Impact and Diseconomies

Consolidation Act: “economies of scale” achievable through consolidation

- And “Economy of Scale” is an increase in efficiency achieved through growth.
- The term is misapplied – spreading costs is not economy of scale.

Acquisitions can demonstrate diseconomies of scale

- Cost savings and gains in efficiency can be eclipsed by higher costs from acquisition premiums and required infrastructure investment.

Reassert the Fundamentals of Ratemaking

1. Ratepayer impact should be the determining factor in the Commission's consideration of acquisition proposals.
 - Just and reasonable rates for ratepayers
 - No unreasonable returns for sellers or buyers
2. Transparency. Rates changes forecasted and implemented in applications. Public benefits should be measurable and documented.
 - Acquisitions should never short circuit the ratemaking process.
3. The Commission's Gain on Sale rules apply when an IOU buys an IOU
 - distribute gains based on ratepayer/shareholder risk.

Rates Forecasts with Application

- Acquisitions are major changes to a water utility's service area, capital, and connections – require Commission review just as in a GRC.
- Under the current framework purchase price is authorized with only illustrative rate change information.
 - No accountability for rate impacts.
 - Purchase price approved by the Commission is *de facto* ratemaking.
 - Utilities have done due diligence to present a fair value price, they should be able to forecast and implement new rates.
- The utility, not ratepayers, should assume the risk of inaccurate forecasts.

Rate Change Forecasts with Applications

Acquisition applications should implement rate changes based on forecasts for all potentially impacted ratepayers.

The D.99 Settlement:

The parties agree that each application should include a forecast of the results of operations 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.*

--

* General Requirements Regarding Acquisitions and Mergers of Public Utilities, Decision 99-10-064 [Appendix D, Section 2.04 Results of Operations]

2006 Commission Decisions on Gain on Sale*

The Commission's 2006 rules allocate Gain on Sale between the IOU seller and ratepayers based on the proportion of risk.

A Gain on Sale exists when an asset is sold for a purchase price that is:

- greater than the original cost of a non-depreciable asset *or*
- greater than the net book value of a depreciable asset

The Consolidation Act shifted water system valuation from Book Value (investment in the system) to Fair Market Value – Δ is Gain on Sale.

--

*D.06-05-041 modified by D.06-12-043 – result of Rulemaking (R.) 04-09-003

Renters' Analogy & Gain on Sale Allocation

Tenants pay rent but do not assume a landlord's risk (i.e., vacancies)
Ratepayers do not own utility property but do assume the risks of ownership.

“Only the risk of the Commission's disallowance of a utility's asset purchase can be said to be borne by shareholders.”¹

2006 Gain on Sale Decisions determine the allocation:²

- ❑ Depreciable assets: 100% Gain on Sale to ratepayers

- ❑ Non-Depreciable: 67% to ratepayers / 33% to shareholders

--

¹ OIR 0409003 & D0605041 Final Decision on Allocation of Gains on Sale of Utility Assets

² D.06-05-041, modified by D.06-12-043

Implementing Gain on Sale

A revised framework should include three requirements for the sale of an IOU to another IOU.

1. Allocate Gain on Sale between IOU seller and ratepayers of the acquired system;*
2. Creates an Allocation Account to administer Gain on Sale via bill sur-credits to offset rate impacts of the acquisition;
3. The acquiring IOU maintains the selling system as a separate ratemaking district until the allocated funds are expended.

--

*As required in D.06-05-041/D.06-12-043

Fair Allocation of Acquisition Costs Levels the Field

The purchase premium should be funded by the ratepayers of the acquired system – offset by the Gain on Sale allocation.

- Unreasonable to burden ratepayers of the buying system with the avoidable purchase premium cost of acquiring a system.
- Book value and improvements funded by all ratepayers.

With Gain on Sale mechanism in place, a revised framework will no longer favor acquisitions of healthy systems with high premiums.

- Failing or troubled systems should not trade with premiums.

Do Acquisitions Benefit the Public?

Economies of scale

- ☒ The reality is diseconomies of scale – rates go up, not down

Improve access to capital

- ☒ If rates are set properly, all systems have ready access to capital

Spread best practices

- ☒ Best Practices are an obligation of every utility, no matter what size

Assist failing systems and secure the Human Right to Water

- ☒ Only if failing systems are the priority...
- ☒ Not if the ability of ratepayers to help failing systems is squandered

See Regulating Mergers and Acquisitions of U.S. Electric Utilities, Scott Hempling, 2020

Conclusion: Acquisitions Are Ratemaking

- ❑ The Commission is the substitute for competition for utilities that function as natural monopolies.
 - ❑ Californians should only ever pay just and reasonable utility rates.
 - ❑ Monopoly utilities should never earn unreasonable returns.
- ❑ Every application to the Commission should be evaluated on measurable impact on rates to *all* ratepayers.
 - ❑ Rates forecast and approved by Commission with the application
- ❑ The fundamental principles of ratemaking apply to acquisitions – *including case-by-case discretion.*

THANK YOU

Workshop 3 Scope: Ratepayer Impacts

1. **How should the Commission examine ratepayer impacts** when reviewing water utility acquisitions? **What tests and criteria** should be used, if any?
2. **Should the impacts on existing customers** of the acquiring water utility be included in the review of ratepayer impacts?
3. **How should the Commission measure the benefits and costs** of water utility acquisitions?
4. **Should rate impacts from previous acquisitions be assessed** when reviewing a proposed water utility acquisition? If so, how?
5. **Should the Commission consider expanding the gain on sale rules** established in Decision (D.) 06-05-041 to address water utility system acquisitions?
6. **Should the Commission consider cost-sharing mechanisms** between ratepayers and shareholders for water utility acquisitions?

Ratepayer Impacts/ Gain on Sale

Time: 30 mins



R.22-04-003

Workshop 3: Ratepayer Impacts

Presented by

Lori Anne Dolqueist, Attorney for California Water
Association

June 13, 2023

Introduction

- The Legislature has found that scale economies are achievable in the operation of public water systems and that providing water corporations with an incentive to achieve these scale economies will provide benefits to customers. (Pub. Util. Code 2719)
- Consolidation also results in many benefits for customers in underserved communities, including lower costs of system operation due to economies of scale, access to the improved technical, managerial, and financial resources of regulated investor-owned water utilities, and access to low-income support and other programs.
- The CPUC has a duty to examine ratepayer impacts to determine whether an acquisition serves the public interest.
- The CPUC should refrain from eliminating existing incentives for utilities to engage in acquisition transactions or imposing new barriers to such transactions.

How should the CPUC examine ratepayer impacts when reviewing water utility acquisitions?

- The CPUC should continue analyzing impacts of water utility acquisitions upon ratepayers of both the acquired and the acquiring water utilities as part of the CPUC's responsibility to determine whether the proposed transaction is consistent with or adverse to the public interest.
- The CPUC should examine ratepayer impacts based on the extensive information required under its Rules, D.99-10-064, and D.20-08-047
- The CPUC should consider: (1) anticipated impacts on rates paid by both bodies of ratepayers, (2) impacts on the quality and reliability of water service, and (3) the availability of specialized service features such as water conservation programs and incentives and low-income ratepayer assistance.

Information Included in Applications

- 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
- Estimate of the potential monthly incremental cost impact on existing and acquired customers
- Estimate of the annual revenue requirement of the system proposed to be acquired, including expected rate of return, expected depreciation expense, O&M expenses, etc.
- Annual depreciation expense using the proposed rate base of the acquired assets
- Known and anticipated general expense savings and efficiencies under buyer's ownership
- Ratepayer benefits that accrue to current ratepayers of the system being acquired due to this transaction
- Detailed reasons of the buyer and the seller for entering into the proposed transaction
- Breakdown of the estimated transaction and closing costs
- Any outstanding compliance issues, including but not limited to water quality violations, that the Seller's system has pending with DDW
- Any outstanding compliance issues that the Seller's system has pending with the US EPA
- If the buyer is seeking authority to increase the acquired system's rates to a certain level, the basis for the targeted rate and period of time for such targeted rate to be implemented

Rates

- Applicants already provide detailed estimates of the rate impact for existing and acquired customers and provide notices to existing and acquired customers.
- Three-year GRC cycle ensures that potential rate impacts from acquisitions are ultimately considered by the CPUC in a timely fashion.
- Buyers frequently do not have the complete information necessary to determine the actual rate increase as a result of an acquisition before that acquisition even occurs. The true costs of operating and maintaining a water system may not be known until the acquiring utility has taken over operations.
- Rate consolidation is better considered in the GRC, so that the CPUC can consider the cost of service of the acquired system and the cost of service of the systems that are planned to be included in the consolidation at the same time.
- Turning acquisition proceedings into mini-GRCs is neither necessary nor efficient.

What tests and criteria should be used, if any?

Ratepayer Indifference Standard

“In weighing the public interest considerations, there have been a handful of Commission decisions applying the “tangible ratepayer benefit,” standard which requires a finding that there is a tangible benefit to ratepayers. By and large, in similar water utility acquisition cases, the Commission has more routinely applied the “ratepayer indifference standard” which requires a finding that [there] is no harm or adverse impact to the ratepayers.”

Should the impacts on existing customers of the acquiring utility be included in the review of impacts?

- The CPUC already considers the monthly incremental cost impact of the proposed transaction on existing customers.
- The CPUC must consider the difference in scale of the likely impacts to existing customers as compared to customers of the acquired system.
- In most cases, customers of the acquired water system will benefit substantially from the greater resources and capabilities of the acquiring utility and may also benefit from more stable and predictable rates, while existing customers of the acquiring utility are likely to be affected only to a modest extent.
- If the overall impact serves the public interest, a negative but minor impact on the existing customer base should be considered just and reasonable.

How should the CPUC measure the benefits and costs of water utility acquisitions?

- The CPUC substantial expertise in determining whether a particular transaction is in the public interest.
- Water system acquisitions are highly fact-specific transactions which depend upon the unique circumstances of each water system, including its history, ownership structure, management capacity, customer base, physical condition and challenges, and future prospects.
- The measurement of benefits and costs of water utility acquisitions must account for these differences and cannot be captured through a generic formula.
- Many arising from consolidation may not be precisely quantifiable with a monetary amount, such greater system reliability, low-income ratepayer support programs, water conservation assistance and incentives, improved community outreach, greater supplier diversity, and improved compliance.

Should rate impacts from previous acquisitions be assessed when reviewing a proposed acquisition?

- Impacts of previous acquisitions are already included in the information provided with the application.
- D.20-08-047 requires applicants to estimate the potential monthly incremental cost impact on existing and acquired customers following the actual results of the buyer's most recently authorized tariffs. If a buyer has pending request before the Commission to change rates, it must also calculate using data as proposed in its pending request.
- If the CPUC decides to further assess rate impacts of previous acquisitions it must also consider the benefits of previous acquisitions.

Should the CPUC consider expanding the gain on sale rules to address water utility system acquisitions?

- No. The gain on sale rules apply only to situations where the assets a utility is selling are no longer used and useful and not in matters involving sales of assets that will continue to be used as they always have been used and thus are used and useful as part of a going concern.
- Expanding the application of the rules to used and useful assets is a drastic change with significant regulatory, legal and financial impacts beyond this rulemaking.
- There is no reason to treat water utility system acquisitions differently from utility acquisitions in other industries.



San Diego Gas & Electric Company
San Diego, California

Revised

Cal. P.U.C. Sheet No.

20161-E

Canceling

Original

Cal. P.U.C. Sheet No.

19351-E

PRELIMINARY STATEMENT

Sheet 3

VI. GAIN/LOSS ON SALE MECHANISM (GLOSM)

D. EXCEPTIONS TO THE PERCENTAGE ALLOCATION RULE

N

The percentage allocation rule does not apply in the following situations:

1. Sale Price/Gain or Loss Threshold - Asset sales where the sale price exceeds \$50 million or the after tax gain or loss exceeds \$10 million.
2. Sale of Entire Distribution System – Allocation of gain to shareholders in limited circumstances where the following conditions are met:
 - a. a public utility sells a distribution system to a governmental entity,
 - b. the distribution system consists of part or all of the utility operating system located within a geographically defined area,
 - c. the components of the system are or have been included in rate base of the utility, and
 - d. the sale of the system is concurrent with the utility being relieved of, and the governmental entity assuming, the public obligations to the customers within the area served by the system.

If the above conditions are met, then the gains or losses from the sale of the system should be allocated to utility shareholders, provided that the ratepayers have not contributed capital to the distribution system and the remaining ratepayers are not adversely affected by the transfer of the system.

Applying the Gain on Sale Rules Would Directly Conflict with the Public Utilities Code

- The CPUC has a duty to promote the legislative and public interest goals of Public Water System Investment and Consolidation Act, which include providing water utilities with incentives to pursue consolidation.
- “[A]pplying gain-on sale rules to used and useful water system asset sales would directly conflict with the Public Water System Investment and Consolidation Act.” D.21-08-002, p. 28.
- Applying the Commission’s gain-on-sale rules to transactions involving assets currently used and useful would extinguish the incentives for buyers the Act means to provide and would make the transactions unviable.

Applying the Gain on Sale Rules Would Have a Negative Impact

- Requiring the buyer in a water system acquisition to allocate a gain on sale amount would significantly change the financial calculus of any potential transaction because the seller would need to increase its sale price offer to reserve funds for subsequently paying the gain on sale allocation.
- Application of the gain on sale rules to water utility transactions would have the perverse consequence of driving up the purchase price demanded by system sellers to account for the gain on sale payment.
- Application of the gain on sale rules likely would inhibit potential buyers from presenting satisfactory offers to the small utility because the prices sellers would demand would then be unattractively high.

There is No “Windfall” for Sellers

- Customers pay just and reasonable rates for water service based on the cost to provide service.
- The prior owner retains all the risks associated with the business prior to sale and the new owner then assumes all the risk of providing service going forward.

Should the CPUC consider cost-sharing mechanisms between ratepayers and shareholders?

- No. The CPUC's duty is to consider whether each transaction serves the public interest.
- The CPUC should refrain from eliminating existing incentives for utilities to engage in acquisition transactions or imposing new barriers to such transactions.
- Consolidation of water systems results in many benefits for customers in underserved communities, including lower costs of system operation due to economies of scale and access to the improved technical, managerial, and financial resources of regulated investor-owned water utilities.
- Even when a water utility is not currently in financial distress, customers benefit from spreading costs over a larger customer base.



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Afternoon Break

10 mins

Afternoon Discussion

Time: 75 mins

Scoping Questions

Afternoon Session

1. How should the Commission examine ratepayer impacts when reviewing water utility acquisitions? What tests and criteria should be used, if any?
2. Should the impacts on existing customers of the acquiring water utility be included in the review of ratepayer impacts?
3. How should the Commission measure the benefits and costs of water utility acquisitions?
4. Should rate impacts from previous acquisitions be assessed when reviewing a proposed water utility acquisition? If so, how?

Scoping Questions (Cont'd)

Afternoon Session

5. Should the Commission consider expanding the gain on sale rules established in Decision (D.) 06-05-041 to address water utility system acquisitions?
6. Should the Commission consider cost-sharing mechanisms between ratepayers and shareholders for water utility acquisitions?

Questions/Comments from Parties

Questions/Comments from Parties

- Please use the “**Raise Hand**” feature in Webex window to request to speak



- Parties will be called on after raising hands, timer will begin when party begins to speak
- **1 minute** is allotted for each speaker
- Timer will start when speech begins

Public Comments

Time: 10 mins

Public Comment

- Please use the “**Raise Hand**” feature in Webex window to request to speak



- **1 minute** is allotted for each speaker
 - Timer will start when speech begins

Closing Remarks