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Water Division Summary Report on Workshop #3

Ratepayer Impacts

California Public Utilities Commission

R.22-04-003

September 12, 2023

I. Introduction

On June 13, 2023, the California Public Utilities Commission (CPUC or the Commission) held the third workshop in a series of workshops via Webex for Rulemaking (R.) 22-04-003. The focus of the third workshop was to discuss ratepayer impacts resulting from acquisitions, the application of the gain on sale rule, and the application of the CPUC's Environmental and Social Justice (ESJ) Action Plan. Commissioner Genevieve Shiroma, Commissioner Darcie L. Houck, and Administrative Law Judge Gerald F. Kelly attended the workshop. The workshop was facilitated by Terence Shia, Director of the Water Division of the CPUC, Mahdi Jahami, Jefferson Hancock, and Kevin Truong also from the Water Division, respectively. The third workshop began at about 9 AM and concluded at about 4 PM.

A total of 6 different agencies, parties, and organizations presented information, case studies, and perspectives on the topics of interest during this workshop. Similar to the first and second workshop, the third workshop was divided into two sessions. The first session, which was held in the morning, included presentations from the University of California, Los Angeles (UCLA); Fisher, Shehan & Colton; and the University of California, Irvine. The second session, which was held in the afternoon, included presentations from A & N Technical Services, Inc.; the Public Advocates Office at the California Public Utilities Commission; and California Water Association. The slide deck used in Workshop #3, which contains the presenters' slideshow presentations, is also attached to the ruling issuing this summary report.

II. Workshop Questions to Parties and Presenters

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

III. Morning Session Presentations

Considerations for Ratepayer Impacts of Acquisitions

Presented by Greg Pierce – University of California, Los Angeles (UCLA) Luskin Center for Innovation

Greg Pierce (Pierce) gave a presentation on considerations for ratepayer impacts resulting from acquisitions. Pierce's presentation focused on how the Commission should examine ratepayer impacts when reviewing water utility acquisitions, if any tests and criteria should be used, and if the impacts on existing customers of the acquiring water utility should be included in the review of ratepayer impacts. Pierce focused on non-municipal systems that are out of compliance with water quality standards.

Pierce described physical consolidation as a limited strategy and noted that less than 40% of water systems on the State Water Resources Control Board's (SWRCB) Human Right to Water (HRW) list (including domestic wells) can be physically consolidated. Pierce also cited the report by UCLA, *Designing Water System Consolidation Projects, Considerations for California Communities*, which describes 215 water system transitions.[1] A follow-up project is underway to analyze affordability explicitly, but it was determined that there is insufficient data to adequately illustrate affordability impacts.

Pierce laid out a proposed procedure for acquisitions. It begins with ensuring regulated water systems comply with the Porter Cologne Water Quality Control Act (PCA), as non-compliance with the PCA would motivate acquisitions. The PCA is not under primary CPUC purview, so improving coordination between the CPUC and SWRCB is necessary to address inadequately operated and maintained systems.[2] The SWRCB and community must lead consolidation efforts in determining if an investor-owned utility (IOU) is the best or only option for consolidation or also consider if regionalization is an option. If an IOU is determined to be the best or only option in consolidation, then the CPUC determines a purchase value and revenue flow developed from a combined system rate structure that allows for a reasonable return.[3] It should also be ensured that water service is affordable for the customers of both the acquired and acquiring systems. The valuation and GRC processes may ensure rate affordability, otherwise state subsidies would need to be sought through the SAFER program or some other new mechanism.[4]

Pierce presented some of the SWRCB's Needs Assessment affordability indicators and recommended that the CPUC rely on and utilize the available metrics in the acquisitions process and in coordination with the SWRCB. The CPUC must clarify its framework and definition of ratepayer impacts before a system consolidation and coordination effort can be developed. The SWRCB must lead the coordination with the CPUC on some type of fund that may serve as an affordability protection for consolidated systems. Safe and Affordable Funding for Equity and Resilience (SAFER) funding does not currently provide enough financial support towards acquisitions. SAFER funds provide $200 million per year, which goes towards capital costs for emergency water needs, which are either add-ons or are supplemental. Pierce reiterated support for a statewide ratepayer assistance program, which would

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provide broader protection to ratepayers, but noted that legislative support is needed to implement such a program.[5]

Water Utility Acquisitions: Protecting Consumer Interests

Presented by Roger Colton – Fisher, Sheehan & Colton

Roger Colton (Colton) gave a presentation on ratepayer impacts and protecting customer interests in water utility acquisitions. Colton's main focus was addressing how the Commission should examine ratepayer impacts when reviewing acquisitions. The four focuses that Colton discussed were: 1) a focus on process, 2) a focus on outcomes, 3) a focus on transparency, and 4) the measuring of costs and benefits.

Colton discussed the focus on process and first addressed the need for transparency. Transparency requires public access to information, which is complete, accurate, available, and reviewable at no cost to the public. Colton listed several types of information, including, but not limited to, studies, proposals, and information on the acquired and acquiring entities; proposed contracts; and long-term capital or affordability plans. Colton then discussed the need for meaningful public participation, which includes public hearings with subsequent public comment periods. The elements of meaningful public participation include the opportunity to participate in decision-making; that such participation can influence the final decision; that the concerns of the public are actively taken into consideration; and that both the acquiring and acquired utilities seek out vulnerable populations to ensure that they have a voice in the process. Colton identified the public hearings and public comment periods as forums for public participation. The last point discussed under a focus on process is the need for seeking public approval or public opinion, such as through a referendum.

Colton then discussed the focus on outcomes. Colton made a distinction between "outcomes" and "activities" and emphasized that this distinction is critical in the acquisition process. Outcomes are the goals which one is aiming to accomplish, whereas activities are the actions that one is currently engaged in. The CPUC should be analyzing outcomes while the acquiring and acquired utilities should identify what they are going to accomplish with respect to improving adequacy and safety of their water supply as well as the equity and affordability of water service. Utility management should decide how their own interests and outcomes would identify measurable objectives in quantitative terms. Objectives are influenced, not just controlled, and there should be continuous monitoring on what "is" and not what "should be." In focusing on outcomes when reviewing an acquisition, the Commission should insist that the acquiring utility identify what they have determined are going to be the outcomes of the acquisition; then determine whether those outcomes have been achieved; and if not, determine what the appropriate response will be.

The next topic Colton discussed was affordability. Colton laid out a three-step measurement of affordability to determine if a utility achieved the affordability outcome it aimed for: the identification of low-income customers, the enrollment of low-income customers in appropriate programs, and the offerings of sufficient assistance to change those customers' payment practices. Payment practices consist of the following elements: completeness of payment and regularity of payments. Affordability should be determined by looking at both the short-term and long-term. Affordability and unaffordability can be broken down into two terms: breadth and depth of affordability. Colton provided a brief case

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example of Baltimore's water affordability to compare the breadth and depth of affordability.[6] Breadth of affordability is the number of customers that have an unaffordable bill. Depth of unaffordability is the extent? to which a bill is unaffordable.[7]

Next, Colton discussed the concept of equity. Colton identified three types of equity: horizontal equity, vertical equity, and equity-plus. Horizontal equity is the devotion of an equal number of resources to achieve an objective. Vertical equity is the number of resources explicitly varied to reflect the differences in needs. Equity-plus is the allocation of resources to sufficiently accomplish sought-after objectives. Equity is generally used to measure two factors: the distribution of burdens (i.e., the costs of acquiring a system) and the distribution of amenities (i.e., bill affordability, customer service, water quality, and system adequacy).[8]

Colton further discussed the focus on the transparency involved in acquisitions. After analyzing impacts, transparency is required in a de facto review to ensure that the outcomes proposed are achieved. Regarding data collection, Colton listed the qualities of and types of information to gather. This includes the collectability of information (such as through bills and receipts); the measurement of customers' failure to pay bills (aging of arrears, the number of bills behind); the efficiency of information collection (deferred payment arrangement (DPA) success, response to disconnection for non-payment (DNP) notices, and if customers contact the utility); and the measurement of DNPs and uncollectibles. Colton identified public reporting as a component of transparency. Public reporting should have a sufficient periodicity (i.e., monthly or annually), sufficient geographical targeting (zip codes, zip codes plus 4), and matching information with demographics (i.e., income, race).[9]

Colton then discussed the focus of measuring costs and benefits. Measurements of costs and benefits are often misused. Colton states that the question with acquisitions is not "do the benefits exceed the costs?" but rather the question should be "is the acquisition accomplishing the outcome?". The analysis does not specify the public policy decision that has been made. In order to be accurate, the measurements of costs and benefits would need to identify the entire range of benefits over time. It also assumes that all financial and economic benefits can be identified, dollarized, and measured, which requires the utility to identify the incremental costs of the bill affordability program. A cost-to-benefit analysis is generally perspective-dependent. For example, when identifying the different types of costs, one can identify insider costs, the costs to the acquired or acquiring entity, outsider costs (the ratepayers), and the social costs and benefits of an acquisition. Colton suggested that instead of a cost/benefit analysis, it might be more appropriate to conduct a cost-effectiveness analysis. A cost-effectiveness analysis will keep the focus on outcome measurements, takes account of the effectiveness in accomplishing outcomes, and improve before-the-fact transparency.[10]

Colton presented the "cost-effectiveness plane", a visual representation that can aid in evaluating an approach. In general, the aim is to achieve the quadrant of more effective and less expensive. The Commission should be monitoring the commitments to the outcomes that acquiring and acquired

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entities have made and then determine how effective the acquisition was on the "cost-effectiveness plane."[11]

Colton concluded his presentation by answering if impacts on existing customers should be included and how the Commission should measure the costs and benefits of acquisitions. Colton argued that impacts on existing customers should be included in the rate base calculation as it would be unacceptable to not include the acquiring utility's customers. Colton discussed measuring costs and benefits in terms of process rather than in terms of quantitative measurements. The Commission should not use a cost/benefit analysis to measure costs and benefits and should use a cost-effectiveness analysis instead.[12]

Environmental and Social Justice Considerations

Presented by David Feldman – University of California, Irvine (UCI), Water UCI

David Feldman (Feldman) gave a presentation on Environmental and Social Justice (ESJ) considerations and intersection with acquisitions in alignment with the CPUC's ESJ action plan. Feldman began with identifying two issues: the identification of vulnerable populations and ensuring the inclusivity of communications from the CPUC downward to the ratepayer level and from the ratepayer level upward to the CPUC.

Feldman acknowledged the central problem concerning failing water systems: that smaller utility systems that serve disadvantaged communities (DACs) and under-represented communities have difficulties in upgrading their infrastructure. These challenges are often what lead to water system failures in terms of security, resilience, and safety. A common solution is to encourage acquisition and consolidation with larger, better financed suppliers. Feldman stated that for a CPUC decision to proactively address the criteria of the ESJ Action Plan, it should address target audiences and should be sensitive to the intersectionality of the respective communities. The three audiences that Feldman identified are DACs, North American Tribes and their need for Tribal Lands, and low-income households and their respective census tracts.[13]

To address the target communities' needs, Feldman recommended that the CPUC anticipate the likelihood of system failure and determine how to avert such failure accordingly. Currently, advice is being sought after a system has already started failing. Feldman recommended expanding coordination with other governing bodies by seeking guidance from Local Agency Formation Commissions (LAFCos) regarding equitable collaboration, enhancing consultation processes with tribal nations, and supporting water agency efforts to become more diverse and inclusive. Governing agencies can diversify to include perspectives that reflect the communities that they serve. Feldman also recommended conferring with vulnerable communities on financing options.[14]

Feldman discussed the ability to predict system failure and the factors that can aid prediction. Small water systems have respectively smaller bases of ratepayers. This results in a smaller pool of resources from which water systems can consolidate to address issues. As such, small water systems lack the

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technical, managerial, and financial (TMF) capacity to operate and maintain themselves on an ongoing basis. In short, the size of a system, the size of its customer base, and TMF capacity can aid in predicting the likelihood of a system's failure.[15]

Feldman then discussed LAFCo oversight of matters in the water industry. LAFCos regulate the boundaries of special districts, determine if companies comply with the Safe Drinking Water Act, and may disapprove of annexations to a city or a special district of territories served by mutual water companies. Feldman cited AB 54 (Solorio, 2011) and the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000.[16] Feldman noted that legislative reform is needed to ensure interventions. Feldman presented a case study on the 2018 Butte County LAFCo review of the Oroville Region Water Service Study. The study analyzed the savings and benefits to ratepayers as opposed to the increased burdens or costs that were not properly captured. The review was a comparative study of cost-effectiveness to render a decision which would address the feasibility of an acquisition. Feldman also presented another case study regarding the 2020 LAFCo analysis of proposals by Fallbrook and Rainbow. This case study illustrated that LAFCos can provide useful service in the form of further level of review, examination, and assessment of the cost effectiveness and equity consideration gains as well as the costs of changing these decisions.[17]

Feldman then discussed addressing issues involving tribal nations. The current methods prescribed by the SWRCB and Department of Water Resources (DWR) for engaging in discussions with Tribes on ratepaying and system consolidation matters are also appropriate for the CPUC to employ.[18] To improve tribal consultations, the CPUC should utilize multiple sources to identify tribes that are impacted by the cultural and historical issues pertinent to acquisitions; confer with tribal-designated leaders to assess potential problems on an ongoing basis; solicit information from tribal nations on ESJ issues as well as tribal ecological knowledge regarding the impacts of acquisitions and consolidations; and maintain preservation of tribal rights and the sustainable management of sacred waters which may be threatened by acquisitions and consolidations. Feldman emphasized that governing agencies explicitly acknowledge that tribal concerns are distinctive issues and that they are not another set of cumulative considerations.[19]

Feldman recommended diversifying governing bodies through the recruitment of under-represented groups. Diversification could be implemented through programs that include recruitment, training, and funding of electoral campaigns of under-represented groups. Feldman noted that the Association of California Water Agencies initiated a committee that fosters diversity in the water industry's workforce and leadership. Feldman also identified other minority-focused groups that are also expanding diversity, such as Water Education for Latino Leaders (WELL) and African American Water Education Foundation.[20]

Feldman discussed affordability as a justice challenge and how this may lead to customers' reliance on bottled water. Small water systems, which serve smaller customer bases that earn lower average incomes, earn revenues that are insufficient to fund necessary upgrade studies or to acquire expertise to

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complete funding applications. Feldman identified the high use of bottled water as a common practice among customers of troubled systems.[21]

Feldman provided several statistics regarding the unaffordability of water service and the usage of bottled water as a substitute. The statistics illustrate disproportionate usage of and spending on bottled water as drinking water among Latinos as well as the disproportionate average cost of tap water compared to bottled water. Feldman stated that recent immigrants to the United States distrust tap water and noted how bottled water vendors employ marketing strategies to exploit differences in perceptions about water.[22] Feldman further discussed health implications of bottled water on the health of children by providing data illustrating usage of bottled water across racial and ethnic groups. There are studies that describe public health issues pertinent to children, such as elevated higher bacterial counts in bottled water with an associated risk of acute diarrheal illness as well as inadequate fluoride intake and oral health implications due to the use of bottled water over tap water.[23]

Feldman listed the available financing options relevant to the CPUC that can assist low-income communities served by failing or near-failing water systems. This includes the Safe and Affordable Funding for Equity and Resilience (SAFER) and Safe Drinking Water Fund (SADW) established by Senate Bill (SB) 200 (Monning, 2019), from which funds can be used towards operations and maintenance costs, system consolidations, emergency water supplies, appointed administrators, other long-term solutions, and administrative costs.[24] The Drinking Water State Revolving Funds (SRFs) are another resource that can assist public water systems that serve small DACs. Debt financing is also an option for larger water utilities that have the legal authority to issue debt. It provides for almost guaranteed returns, and the tax-free nature of municipal bonds may incentivize certain investors. However, smaller agencies that need to raise large amounts of capital may be reluctant to utilize debt financing out of fear of "rate shock" for their customers.[25]

Morning Discussion Session

Questions and Comments from Commissioner Genevieve Shiroma

During the morning discussion session, Commissioner Shiroma inquired with Feldman if there are any studies regarding bacteria, fluoride, and the impacts of bisphenol A (BPA). Feldman noted that there are ongoing public health studies for schools and that results are currently uncertain. Sources of BPA may come from bottled water and other sources of plastic but are also present in the environment. Regarding dose response issues, they are currently lagging since there is little to no categoric proof on how BPA may affect the health of children. However, these long-term results may emerge later.

Questions and Comments from Commissioner Darcie L. Houck.

Commissioner Houck commented on the SWRCB's Human Right to Water list and ensuring that at-risk systems can adequately provide water service. Commissioner Houck requested recommendations on how the CPUC can coordinate with both the SWRCB and with local entities in defining affordability. Commissioner Houck noted that rate impacts do not affect all ratepayers equally and that not all

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ratepayers are circumstantially equal. Commissioner Houck asked the morning session presenters where there are observable disconnects between the level of rates charged and the ability of people to pay those rates in specific areas. The CPUC can consider a combination of findings from the SWRCB and the DWR on information such as defaults on bills, the high rate of individuals that have asked for bill deferral due to affordability of rates, and the comparison of rates to average income in an area. Commissioner Houck noted that the SWRCB engages in conversations on districts that are failing or at-risk and convenes with experts from other agencies to draw on their expertise. Pierce recommended to start coordination with the SWRCB at the staff level to analyze the HRW list to determine which systems are approximate to regulated utilities for potential consolidations. Pierce noted that there is no single affordability metric and pointed at the SWRCB's various metrics, among which the CPUC may select from to incorporate into its own metrics. Pierce supports the realization and tracking of those metrics.

Question to Roger Colton: How could analysis of ratepayer impacts be standardized or become more consistent in acquisitions?

Colton identified 6 areas where standardization would be helpful. The first is a set of standardized data requests for acquisitions, which a minimum data request (MDR) process for acquisitions could address. The second is a set of standardized definitions to identify low-income and vulnerable populations. The definitions should be determined such that the CPUC itself acknowledges those communities. The third is a set of standardized identification of outcomes. The outcomes do not have to be the same for every acquisition. The CPUC should identify the universe of outcomes that it wants acquiring utilities to address while allowing the utilities to note which outcomes they are not addressing through a particular acquisition. The fourth is to identify standardized outcomes monitoring and reporting processes. CPUC staff would stay informed after an acquisition decision has been issued. Over time, both short-term and long-term considerations would be made. The CPUC would have to define what the outcome reporting would be for acquiring entities. The fifth is the development of a feedback loop after the completion of an acquisition, which Colton identifies the CPUC as not having. The CPUC must define a standardized process to establish this feedback loop: determine the expected outcomes, determine how the outcomes are measured, determine the data needed, establish how the data will be analyzed, and integrate the data into future actions. Lastly, Colton described that a process should be made to produce a logic model underlying an acquisition. Colton's firm developed a "how/why" model which starts with the acquisition.

Question to David Feldman: How important is the ratepayer impact on existing customers on the acquiring utility?

Feldman emphasized the importance of these ratepayer impacts. Existing ratepayers may find themselves in the situation of being asked to subsidize the needs of the less resourced utilities' customers and needs. Existing customers subsidize the expansion of infrastructure and needed improvements for the acquired system's customers. An acquisition can impose more of a burden on customers over the long-term benefits that accompany the repair and upgrades to infrastructure. Feldman emphasized to try not to reduce the voting power of the existing jurisdictions. Feldman noted that the greater the degree of severity of failure is on the acquired system, the more likely that the burdens to rectify those failures on the part of the existing ratepayers is high rather than modest or low. Feldman stated that the CPUC should be prepared to advise on the length of time that may be required to address the problems and the needs of the acquired system as well as the ratepayers' needs. The CPUC should also examine whether the ratepayer impacts on existing customers are likely to be permanent or temporary and to what scale the impacts would be. Feldman stated that consultation must be expected to be performed by all stakeholders.

Question to Greg Pierce: How should the benefits and costs of acquisitions be quantified?

Pierce responded by describing the benefits and costs for receiving and subsumed systems. In quantifying costs, the three tenets of the Human Right to Water should be considered (quality, reliability, and affordability), along with the impacts to governance and participatory impacts and the potential growth of the utility. Pierce emphasized the need for communication to customers of both systems, particularly with those of the subsumed systems. Customers of subsumed systems may be uninterested in acquisitions and may not see the extent of the burdens of poorer water quality. The long-term benefits of acquisitions should be communicated to these customers accordingly.

Question to Greg Pierce: How should rate impacts from previous acquisitions be assessed when reviewing a proposed acquisition?

Pierce noted that an adequate amount of data regarding the affordability of bills pre-and post-acquisitions on existing and recent acquisitions is not yet available to parse out significant factors to use to predict future rate impacts. The circumstances of acquisitions can differ between different transactions and as time progresses, the regulatory environment may also change. The SWRCB has distilled the data collection process down to the level of bill tracing and revenue requirements. Pierce stated that five to ten years of data would be an adequate start to develop a database for prediction analysis.

Questions and Comments from Parties

Lori Dolqueist (Dolqueist), representing California Water Association (CWA), expressed concern that the CPUC was not analyzing the impact to existing customers. Acquisitions applicants are required to examine the existing rates of the acquired system. Dolqueist also noted that the CPUC has been collecting information on arrearages in line with the CPUC's Low-Income Rulemaking proceeding. Dolqueist inquired with Feldman how customers' faith in tap water is restored after they develop dependence on bottled water during moments of odor, water taste issues, or boil water orders. Feldman described a trend in which customers first distrust tap water and rely on bottled water. As customers develop dependency, they absorb costs on a household level and are convinced that it is more helpful than tap water, maintaining bottled water use. Inter-generational dependency on bottled water may also develop. Children may develop a habit of relying on bottled water if parents continue to provide only that option. Dolqueist also expressed concerns about using cost-benefit analysis to assess acquisition transactions and requested the morning presenters to elaborate on why cost-benefit analysis is not the best option. Regarding a cost-effectiveness test, the CPUC should develop a policy including options on how decisions are achieved and acknowledge that those options have different costs. Regarding the prevention of system failure and approving affordability, if the CPUC were to say that the objective is to prevent failure, then costs and benefits are no longer relevant. At that point, it should be determined what the most cost-effective method is that should be pursued to achieve the objective. This implicitly assumes that there are other options available. Colton stated that the CPUC should articulate a set of outcomes that it is seeking through acquisitions. Pierce noted that the SWRCB has already modeled the cost effectiveness of specific solutions, to which acquisitions are the most cost-effective method. Dolqueist inquired on the low-income support programs that are offered by the Class A utilities regulated by the CPUC and how to quantify and compare the benefits of these types of programs between utilities that have and do not have them. Feldman distinguishes affordability between the community perspective and the household or customer perspective. In the scale of a utility or water system, one can measure changes in payment patterns through the completeness of payment, the regularity of payment, and the timeliness of payment. From a social perspective, low-income support programs provide improved stability to neighborhoods.

Comment from Melodie Chrislock – Public Water Now

Regarding the impact of acquisitions on existing ratepayers, Melodie Chrislock (Chrislock) inquired of the reason why the gain on sale rules have not been applied to regulated water utilities. Chrislock expressed concern about the overall commodification of California's water supplies. Chrislock recalled the acquisition of East Pasadena Water Company (East Pasadena) by California-American Water Company (Cal-Am), in which East Pasadena had a book value of $4 million and was eventually sold to Cal-Am for $34 million, allowing East Pasadena to earn a profit of $30 million, or a 750 percent profit at the expense of the ratepayers. If the Commission applied the gain on sale rules, East Pasadena would have instead realized a $8.9 million profit on a total investment of $6.2 million, which Chrislock characterized as a reasonable return of 140 percent.

Public Comment Session

Public Comment from Ratepayer

A public commenter followed up Chrislock's comment regarding Cal-Am's acquisition of East Pasadena and the resulting profit that is passed on to existing ratepayers. The commenter pointed out the issue of subsidies from lower-middle class ratepayers in California. Although there are ratepayer assistance programs for customers that earn a household income that is 200 percent below the poverty level, lower-middle class ratepayers are subsidizing acquisitions. This ratepayer class includes senior citizens on fixed incomes. The commenter urged for the consideration of these customers and the high utility rates imposed on them across multiple utilities.

IV. Afternoon Session Presentations

Customer Impacts of Water Utility Acquisitions

Presented by Thomas Chesnutt – A & N Technical Services, Inc.

Thomas Chesnutt provided a presentation about the customer impacts of water utility acquisitions. Systems being acquired can potentially have various levels of service issues. These issues can include, but are not limited to, imperfect billing system data, collection accounts, poor asset management, deferred renewal and replacement, lack of a water loss control program, little observable water use efficiency, low customer outreach, inefficient staffing, and imperfect regulatory compliance.[26] Many customer costs are direct and easy to measure, while customer benefits are diffuse and difficult to measure. Cost of water service has exceeded general inflation by a factor of more than three since 2000.[27] Cost drivers include the increasing cost of source water, water quality treatment costs, distribution rehabilitation, customer service expectations, and regulatory compliance costs.[28]

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[27] Slide 62
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The advantage of the acquiring utility is that they are often larger in size and scope. This can be captured with the notion of economies of scale because there is lower average cost of scale. It is not just economies of scale that determine lower average cost of scale, but also economies of scope. Economies of scope is the lower total cost across multiple services that water utilities are being asked to provide. This does not only include safe drinking water but also other "One Water Services." The "One Water Services" include services for potable water, recycled water, wastewater, water efficiency, and stormwater. The One Water Cycle from the Water Research Foundation has four steps: 1) water treatment, 2) wastewater treatment, 3) advanced treatment, and 4) stormwater management. Chesnutt noted there are synergies through the One Water Cycle.[29]

Chesnutt provided a case study to demonstrate some of the issues that may happen during an acquisition. In the "Digital Twins" case study, Utility B is being acquired and Utility A is the acquiring utility. Utility B was a public utility; it had a history of rate litigation; and it had 8 years of constant rates. Utility A was also a public utility; was familiar with wastewater infrastructure deficiencies; had a fixable rate structure; and a complimentary supply portfolio. Utility B was about 20% the size of Utility A and was located right next to Utility A. Numerous benefits were realized about one and a half years after the acquisition, such as greater operational efficiency, and approximately 20% of pre-acquisition operational expenses. For the infrastructure renewal and replacement, CIP (Capital Improvement Projects) more than doubled and was funded out of the operational efficiencies. The average bill change was limited to less than 5% during the transition period and 7% thereafter. They achieved higher levels of customer service, water use efficiency, and water loss control. Finally, they also noted synergies with their water resource portfolios which made the collective system more resilient than the two systems were when they were separate.[30]

IOUs can be part of water solutions. Chesnutt moved to discuss his findings on the case study. Uncertainty should be expected in acquisitions. There are many things that will only be discovered through the operation of a system, such as uncharted meters and incorrect customer information. Chesnutt recommended a rate transition period to mitigate any customer bill impacts. Using a rate ramp builds customer engagement and trust. Synergies can reasonably be expected to occur, including but not limited to, management, staffing efficiencies, compliance efficiencies, and company capacity building, particularly improvements to levels of services. Lastly, he recommended there be graduated acquisition information requirements to provide transparency between the utility and the ratepayers.[31]
IOUs in California have a competitive advantage in affordability. Many of the currently regulated investor-owned utilities have customer assistance programs that are subjected to regulatory scrutiny. Many public water utilities in California have given up on customer assistance programs because they consider themselves constrained under Proposition 218, which does not apply to private utilities.

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Ratepayer Impacts/Gain on Sale

Presented by Eddie Scher – Public Advocates Office at the California Public Utilities Commission (Cal Advocates)

Eddie Scher provided a presentation on ratepayer impacts and the application of the gain on sale rule. Scher began his presentation by discussing how the revised acquisition framework should reassert the basic principles of ratemaking with guidelines that protect ratepayers, while still achieving public policy goals. The main goals and guidelines of the revised framework should put ratepayer fairness as the top priority; should not setup windfall profits for utilities; level the playing field between healthy and failing systems; and prioritize failing systems.[32] The Commission is responsible for ensuring fair rates. The standard for review is that acquisitions are fair and reasonable to ratepayers and the test of reasonableness is ratepayer indifference. Ratepayer indifference is a lower standard than ratepayer benefit, but by any standard the cost and benefits of an acquisition should be measured and presented in an acquisition application. The current framework relies on theoretical benefits and that is not enough to protect ratepayers. Ratepayers are not indifferent to unreasonable returns.[33]

For acquisitions, the Commission has determined that ratepayer fairness needs to come first.[34] Scher gave the example of the 2021 decision on the San Gabriel Water Company acquisition of Montebello's water system (D.20-12-002). Fair Market value does not outweigh the Commission's responsibility to protect ratepayers. From the ratepayer's perspective, acquisitions can achieve public and ratepayer benefits by helping failing water systems. Under the current framework, acquisitions circumvent ratepayer fairness, transparency, and the ratemaking process. This has resulted in sellers realizing unreasonable profits; ratepayers funding full returns on acquisition prices; ratepayers paying sellers for utility assets; and ratepayers paying sellers again for the same assets. IOUs responding to an RFP is not a market because ratepayers remain on the hook for the full cost and risk of ownership and assets.[35]

Class A IOUs are pursuing acquisitions to grow their businesses. Scher described the acquisition growth strategy of IOUs and noted that 25% of California American Water Company's (Cal-Am) parent company's growth for the year of 2023 would be through utility acquisitions. Acquisitions are important business opportunities for large water utilities, and they do not need to be provided with special treatment through a revised framework. Scher answered the question of "what are the public and ratepayer benefits of water system acquisitions and consolidation?" The benefits to troubled and failing systems, as well as system buyers and sellers, is very clear because they are measurable in dollars. It is the benefits to the public and ratepayers that are not clear and have been presented in theoretical terms and applications. A revised framework should require that applications define and document specific measurable benefits to the ratepayers and public.[36] The 1997 Consolidation Act talks in general terms about economies of scale achievable through consolidation and applications cite economies of scale and a ratepayer benefit. An economy of scale is an increase in efficiency achieved through growth. In the context of acquisitions, the term is misapplied. Spreading costs across a larger pool of customers

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is not the same as increasing efficiency. Efficiency is measurable using the cost per customer or other measurements.[37]

To ensure ratepayer fairness, there are three things that a revised framework should do. It should reassert that ratepayer impact should be the determining factor in the Commission's consideration of acquisition proposals; rates should be forecasted with an application; rate changes should be implemented with Commission approval with an application; and the Commission's 2006 rules on Gain on Sale should apply when an IOU buys another IOU.[38] Rates should be forecasted and implemented with an acquisition application. Acquisitions are major changes to a water utility's operations and rates. These types of changes require the Commission's review and approval just as in a general rate case (GRC). Under the current framework, the acquisition purchase price is authorized by the Commission, but the actual rate changes wait until the next GRC. This means there is no accountability for bill impacts at the time of approval of the purchase price. Acquisitions operate under a different set of rules than traditional ratemaking.[39] Utilities should be able to forecast and implement rates and live with the rate forecasted just as they do with other ratemaking situations. Acquisitions should not be handled by after-the-fact bill charges. The D.99-10-064 Settlement Agreement includes language that requires both the presentation of the results of operation, and that all ratepayers are considered. In order to achieve more fairness, a revised framework should reassert that forecasts are represented and implemented with applications. The utility, not ratepayers, should assume the risk of inaccurate forecasts.[40]

In 2006, the Commission completed a rulemaking regarding application of gain on sale allocations. Scher cited D.99-10-064 and D.06-05-041 (further modified by D.06-12-043 and was a result of Rulemaking 04-09-003). Gain on sale rules apply when an IOU is purchased by another IOU. Gain on sale exists when an asset is sold for a purchase price that is both greater than the original cost of a non-depreciable asset and greater than the net book value of a depreciable asset. The 1997 Consolidation Act shifted water system valuation from book value to fair market value, from which the difference between the amounts is the gain on sale. Gain on sale applies to water system assets, whether it is a single asset, a group of assets, or the entirety of the assets. The rule states that they apply to the sale of all used and useful assets.[41]

Scher laid out an analogy about renters and tenants to make a comparison to the gain on sale allocation. Tenants pay rent but do not assume any risks associated with owning the rented property. Ratepayers assume most of the risk of ownership of the system even though they do not own utility property. D.06-05-041, modified by D.06-12-043, established the gain on sale of allocation with 100% of the gain on sale of depreciable assets and 67% of the gain on sale of non-depreciable assets being returned to ratepayers; 33% of the gain on sale of non-depreciable assets returned to the shareholders; and the seller keeps their full investment.[42]

The revised framework should include three things when an IOU buys another IOU: 1) allocation of the gain on sale between the seller of an IOU and the ratepayers of the acquired system; 2) creation of an

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allocation account to administer the gain on sale via bill sur-credits to offset any rate impacts resulting from the acquisition; and 3) the requirement for the acquiring IOU to maintain the selling system as a separate ratemaking district until the allocated funds are expended.[43] Allocating gain on sale will provide equity between troubled and non-troubled water systems. The purchase premium should be funded by the ratepayers of the acquired system and be offset by the gain on sale allocation. It is unreasonable to have the ratepayers of the buying system pay for the seller's profit. By applying gain on sale allocations, a revised framework will no longer favor the purchase of non-troubled water systems with high premiums over the purchase of troubled systems. Failing or troubled systems are not likely to trade with large purchase premiums.[44]

The general and theoretical benefits of acquisitions do not necessarily justify the measurable impacts that ratepayers see from acquisitions. The reality of the concept of economies of scale is actually diseconomies of scale, given that rates increase rather than decrease. Acquisitions should improve access to capital, but if rates were set properly, all systems would have ready access to capital. Acquisitions should spread best practices, which are an obligation of every utility, regardless of size. Acquisitions can be a solution to remedy failing water systems only if they are prioritized, not if the ability of the ratepayers to help failing systems is squandered by paying high premiums for non-troubled systems. Acquisitions can provide public and ratepayer benefits, but only if the revised framework provides measurable costs and benefits that protect ratepayers.[45]

To protect ratepayers, the Commission must substitute for competition between utilities that function as natural monopolies. Californians should only pay just and reasonable rates, and monopoly utilities should not earn unreasonable profits. Every acquisition application should be evaluated based on the measurable beneficial impacts on rates to all ratepayers. Rate changes should be forecasted in an application, and those rate changes should be implemented with the approval of the application. No established framework has the ability to anticipate every scenario, so the CPUC must use discretion to balance the cost of benefits and make the best decision for the ratepayers. This is important because there may be situations where in all other respects, an acquisition is unappealing, except that there exists a public benefit for the acquisition to provide ratepayer with clean and potable water service.[46]

Ratepayer Impacts/Gain on Sale

Presented by Lori Dolqueist – Legal Counsel of California Water Association (CWA)

Lori Dolqueist (Dolqueist), representing California Water Association (CWA), provided a presentation on ratepayer impacts and the existing gain on sale rules. Dolqueist emphasized that spreading the costs of acquisitions to a wider customer base benefits all customers. Small, well-maintained water utilities are acquired to prevent them from becoming at-risk or failing utilities under the SWRCB’s SAFER Needs Assessment definitions. Once a water system has a water quality issue, customers lose faith in tap water and begin to rely on bottled water, with those habits transferring intergenerationally. Dolqueist’s presentation includes direct responses to the workshop questions listed in Section II of this report.

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Dolqueist's response to "How should the CPUC examine ratepayer impacts when reviewing water utility acquisitions?"

Dolqueist recommended that the CPUC continue the analysis that it has been doing to determine if a transaction aligns with public interest or not. All information examined for an acquisition application is currently submitted under rules set forth in D.99-10-064 and D.20-08-047. Dolqueist suggested that the CPUC consider the anticipated impacts on rates imposed on both the acquired and acquiring ratepayers; the impacts on quality and reliability of water service; and the availability of specialized service features such as water conservation programs and incentives as well as low-income ratepayer assistance programs. Dolqueist emphasized that applicants already provide an adequate amount of information in applications.[47] Dolqueist provided a list of information required to be included in acquisitions applications.[48]

Dolqueist stated that the CPUC, Cal Advocates, and ratepayers already have rate impact information for existing and acquired customers. Dolqueist attested that utilities do not have the costs to operate the consolidated system at the time of application and would not have the information until the consolidated system is actually operated. Dolqueist recommended that considerations on rate consolidation from acquisitions should be handled in acquiring utilities' GRCs and not in acquisitions proceedings. Dolqueist stated that it is unnecessary and inefficient to treat acquisitions proceedings similarly to GRCs. Dolqueist attested that customers and the CPUC already have the information to determine if an acquisition is in the public interest. [49]

Dolqueist's response to "What tests and criteria should be used, if any?"

Dolqueist provided an excerpt from D.22-08-005 describing the application of the ratepayer indifference standard to gauge public interest considerations and recommended continued use of the standard.

Dolqueist's response to "Should the impacts on existing customers of the acquiring utility be included in the review of ratepayer impacts?"

The CPUC already considers the monthly incremental cost impact of a proposed transaction on existing customers. Dolqueist stated that when the CPUC considers these impacts, it looks at the scale of the likely impacts on the existing system's customers compared to those on the acquiring system's customers. Although there may be an increase to the existing customers' bills, there are many benefits to the acquired customers. These benefits include the greater resources and capabilities of the acquired utility as well as more stable and predictable rates. If the overall impact serves the public interest, a minor negative impact on the existing customer base should be considered just and reasonable.[50]

Dolqueist's response to "How should the CPUC measure the benefits and costs of water utility acquisitions?"

Acquisition transactions can vary based on the unique circumstances of each water system. Dolqueist noted that not all costs and benefits are quantifiable and that acquisitions must account for the different circumstances between acquired water utilities. Such qualitative factors include low-income support programs, water conservation assistance and incentives, improved customer outreach,

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improved water system reliability and supply resilience, and improved compliance with regulatory standards. Dolqueist recommended that the CPUC continue to consider these factors.[51]

Dolqueist's response to "Should rate impacts from previous acquisitions be assessed when reviewing a proposed acquisition?"

Dolqueist stated that the impacts of previous acquisitions are already included along with information provided in an acquisition application. Dolqueist cited D.20-08-047, which requires applicants to estimate monthly incremental cost impact on existing and acquired customers. Dolqueist recommended that the CPUC look at the benefits of previous acquisitions in addition to the rate impacts of those acquisitions.[52]

Dolqueist's response to "Should the CPUC consider expanding the gain on sale rules to address water utility system acquisitions?"

Dolqueist recommended that CPUC should not apply the gain on sale rules, and that the rules apply only to situations where the seller's utility assets are no longer used and useful. Expanding the application of the rules to include used and useful assets is a drastic change that includes significant regulatory, legal, and financial impacts that lie beyond this Acquisitions Rulemaking. Dolqueist stated that there is no reason to treat water utility system acquisitions differently from acquisitions in other industries.[53] Dolqueist presented San Diego Gas & Electric (SDGE) tariff sheet no. 20161-E, which describes exceptions to its gain or loss on sale allocations.[54]

Dolqueist stated that expanding the application of gain on sale rules to acquisitions would directly conflict with PU Code. Dolqueist cited D.21-08-002, page 28, which states that the application of gain on sale rules to used and useful water system asset sales would directly conflict with the Public Water System Investment and Consolidation Act. Dolqueist stated that applying the gain on sale rules to transactions involving currently used and useful assets would remove the incentive for buyers that the Public Water System Investment and Consolidation Act provides for and would make those transactions unviable.[55]

Dolqueist further stated that applying the gain on sale rules to acquisitions would have a negative impact. It would change pricing calculations by the seller by increasing the sale price to include reserve funds to account for the gain on sale payment. Also, it might inhibit potential buyers from presenting satisfactory offers to the small utility since the prices that the seller would demand would be unattractively high.[56] Dolqueist stated that there is no profit windfall to sellers. Customers must pay just and reasonable rates for water service based on the cost of providing water service. The prior owner is responsible for risks associated with their water system prior to the sale, then the acquirer assumes those risks after the transaction.[57]

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Dolqueist's response to the question "Should the CPUC consider cost-sharing mechanisms between ratepayers and shareholders."

Dolqueist responded that the CPUC should not consider such mechanisms and that the CPUC's duty is to consider if the transaction serves the public interest. Dolqueist stated that the CPUC should not remove existing incentives or create new barriers to acquisitions. Consolidations provide benefits to customers in underserved communities, such as lower costs of system operation, cost spreading over a larger customer base, and access to improved TMF resources from the acquiring IOUs.[58]

Afternoon Discussion Session

Questions and Comments from Commissioner Genevieve Shiroma

Commissioner Shiroma stated that as a certain type of acquisition application moves forward, there is an election involved. Materials involved include the estimated cost impact and estimated monthly bill increase. Commissioner Shiroma inquired with Lori Dolqueist if any of CWA's members tracked those estimates involved with acquisitions and what happened in their GRCs and with what has been approved. Dolqueist noted that actual incremental costs are not separately identified but are included in GRCs. The amounts are not highlighted or specifically identified. Commissioner Shiroma stated that the convention is that the acquisition is not dealt with immediately and is folded into the GRC and inquired on what would happen if an acquisition was implemented in real time. Dolqueist noted that acquisitions are difficult to predict and are not synced with GRCs. It cannot be assumed that the processes are synchronized. There is insufficient information to provide just and reasonable rates for the cost of service of the acquired system until the system is actually acquired and operated. Until a system is operated for an adequate period of time, the costs related to that acquired system cannot be determined.

Question to Presenters: How should the Commission examine ratepayer impacts when reviewing water utility acquisitions? What tests and criteria should be used, if any?

Chesnutt responded that a system to estimate prospective ratepayer impacts already exists. However, he noted concerns that the tests that exist are often hyper focused on the easy-to-measure, which he believes means the benefits play a lesser role in weighing. The benefits can be described qualitatively, which would already be included in acquisitions applications.

Scher responded that the new framework should set a stage for fair ratemaking. He asserted that the idea that the CPUC gets the information it needs in the application to understand ratemaking, but the CPUC not receiving the information to set rates is contradictory. A new framework can drill deeper into what the actual costs and benefits of these acquisitions are. The Consolidation Act is focused in its language on troubled and failing systems and underserved communities. In providing incentives and opportunities to be acquired, this is how it should be. A challenge that the revised framework should address is that every system is not failing or troubled. The vast majority of acquisitions involve non-troubled or non-failing systems. Scher stated that purchase price and rates should be separated. There should be complete information at the time of approval. Future infrastructure costs can be deferred and separated. The utility must forecast rates and must settle for those rates. Acquisitions should not push those costs off to be addressed as surcharges.

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Dolqueist stated that the focus of the Consolidation Act is on utility size. It is not focused on troubled systems and is focused on utility size given the legislative history and the language of the Act itself. Regarding activities and provision of related information, Dolqueist identified the ratepayer indifference standard, which can inspect intangible information such as reliability and rate impacts. Dolqueist noted that rate cases contain much wider information available to which the CPUC can still assess if an acquisition is reasonable. Rates that are immediately put into place are unfair since they would not properly represent the actual cost of service.

Question to Presenters: Should the impacts on existing customers of the acquiring water utility be included in the review of ratepayer impacts?

Chesnutt replied that it would not have a detectible effect in terms of the existing customer base if that customer base were very large.

Question to Presenters: How should the Commission measure the benefits and costs of water utility acquisitions?

Chesnutt responded that costs are easier to measure and are more obvious, but this does not mean that the benefits are not as prevalent. Potential benefits going forward are often large. In terms of affordability, it should be asked if a customer can afford substandard water service.

Scher responded that the CPUC should coordinate with the Class A water utilities to determine the measurable benefits and costs. The acquisitions process is the best forum to receive information on ratepayer impacts and public benefits of acquisitions. The current framework seems to rely heavily on general theoretical benefits of consolidation. Because we see real ratepayer impacts from things like massive purchase premiums and buyers walking away with huge profits from acquisitions, we need to see more information on the other side of the scale. Scher stated that the information already exists and that the revised framework should require the information that is readily available. The cumulative impact of acquisitions is considered by the CPUC. Scher emphasized that Class A IOUs are targeting acquisitions as a method to grow their businesses. To the extent that the chart of cost-per-connection shows exponential growth in cost sharing, both the efficiency of these transactions (in terms of ratepayer fairness) and the cumulative impact on rates should be analyzed. For people that earn fixed incomes, these appear as surcharges on their bills. There is a margin for ratepayers of systems to pay for the public benefit of acquisitions. That margin should be spent on troubled and failing systems first. The current framework allows all acquisitions to be grouped together and treated the same.

Dolqueist responded that not all costs and benefits are measurable, such as water system reliability, access to beneficial programs, and increased compliance with regulatory standards. Dolqueist stated that the CPUC has the ability to do a factual assessment of the aforementioned factors. There are differences between acquisitions of troubled systems and acquisitions of non-troubled systems. There is more certainty in more efficient acquisitions proceedings. The information that is analyzed by the CPUC is already being provided in acquisitions applications. There is no need to require additional requirements to applicants, which might slow down the acquisitions process.

Question to Presenters: Question to Presenters: Should rate impacts from previous acquisitions be assessed when reviewing a proposed water utility acquisition? If so, how?

Chesnutt responded that they should not be assessed as each acquisition case is different, the context of the acquisition is different, and that inferential hazards are abounding.

Question to Presenters: Question to Presenters: Should the Commission consider expanding the gain on sale rules established in Decision (D.) 06-05-041 to address water utility system acquisitions?

Scher replied that the gain on sale rule should apply to used and useful assets. Unused and useless assets should never be paid for by ratepayers. The revised framework should set the stage for ratepayer fairness and establish the principles of fair ratemaking. This includes the application of the gain on sale rules.

Dolqueist reiterated that D.21-08-002 directly addresses this question on page 27 of the Decision. Changing the gain on sale rules has significant effects that lie beyond this Rulemaking.

Question to Presenters: Should the Commission consider cost-sharing mechanisms between ratepayers and shareholders for water utility acquisitions?

Scher reiterated that the gain on sale rules should be applied.

Dolqueist responded that the CPUC's focus should be on maintaining current incentives and adding incentives rather than adding disincentives.

Questions and Comments from Parties

Melodie Chrislock – Public Water Now

Melodie Chrislock (Chrislock) inquired on how a 750 percent profit is not a profit windfall. Chrislock asked the CPUC whether the gain on sale rules should apply to used and useful assets or not and expressed that it does not make sense for these rules to apply to assets that are not used and useful. Chrislock expressed suspicion that the IOUs argued strongly against the changing of the gain on sale rules, which implies that the current rules benefit IOUs.

Chrislock does not see the current rules benefiting the general public. Chrislock described the circumstances surrounding the proposal where California-American Water Company (Cal-Am) was offered $449 million for its Monterey system by the Monterey Peninsula Water Management District. Cal-Am refused to sell the assets and the sale may end up in an eminent domain proceeding. Chrislock expressed concern that if the sale of the assets goes through, Cal-Am should not be allowed excessive profits at the ratepayers' expense.

Chrislock stated that the gain on sale rules exist to protect the public from monopolies, but it does not appear that the Commission rules currently do so. Chrislock urged the CPUC to view this issue from the ratepayers' perspective.

Paul Goodman – Center for Accessible Technology

Paul Goodman (Goodman) stated that there may be conflation with the CPUC's public interest inquiry into acquisitions and the legislative intent behind the Consolidation Act. Goodman cited the Consolidation Act, which states that "[p]roviding water corporations with an incentive to achieve scale economies will provide benefits to ratepayers." Even if water utilities are provided with incentives, an acquisition may still not meet the public interest standard. The CPUC Decision cited by Lori Dolqueist, states that although PU Code Section 854(b) and (c) do not apply to water companies, there are factors that would be helpful for the CPUC to consider towards acquisitions. One of the factors is determining if there is equal sharing of economic benefits of a transaction between ratepayers and shareholders. The failure to share earnings from the gain on sale rule could be considered a public interest harm.

Nicholas Subias – California American Water Company (Cal-Am)

Nicholas Subias (Subias) discussed his prior experience with acquisitions. Subias stated that there were statements made revolving around the acquisition of East Pasadena Water Company (East Pasadena) by Cal-Am and windfall profits without citations to the record of that acquisition proceeding. Subias noted the history of East Pasadena, and that the predecessor company was founded over one hundred years ago. Subias noted that a 700 percent profit would appear excessive if it were for a utility operating for a shorter amount of time (such as for one to four years or even for twenty years). However, the amount of money initially invested into the company inflated in value over its lifetime. Subias stated that in employee testimony in the record, East Pasadena's process was to reinvest the money it earned from operations back into the company. Continuous reinvestments in the company occurring over a long period of time lead to the profits from the sale appearing more reasonable. Additionally, $26.7 million dollars of the purchase price were for water rights, which are adjudicated in the Central Basin and the Raymond Basin in Southern California. Subias stated that there is a robust market for water rights in Southern California and that market sets the value of water rights. Subias stated that there is no manipulation by investor-owned utilities in the water rights market. Subias continued by noting that in the East Pasadena acquisition application, Cal-Am included cost savings, including savings associated with water rights. Water rights would allow for the pumping of groundwater at lower prices as compared to the price of purchasing water. Subias noted that Cal-Am's most recent acquisitions of properties that do not have water rights are approximately five to six thousand dollars per connection.

Subias responded to Commissioner Shiroma's inquiry on additional complexities produced by the "marrying" of the general rate case (GRC) process with the acquisitions process. Subias noted that Cal-Am's GRC decisions and acquisition decisions were both commonly delayed. Combining the two processes would add more complexity to the acquisition process. In the Fruitridge Vista Water Company (Fruitridge Vista) acquisition, Cal-Am proposed rate increases for specific capital projects to meet the State of California's metering mandate deadline of 2025. Cal Advocates was opposed to this and instead proposed a robust rate case to review those matters. Cal-Am was eventually given authority to establish a memorandum account to address the capital project at a later time. D.20-08-047 addressed the matter of the consideration of acquisitions outside of GRCs and decided that the Commission should indeed do so.

Janice Hanna – Del Oro Water Company

Janice Hanna (Hanna) discussed the examination of rate impacts in the review of an acquisition application. Del Oro Water Company (Del Oro) has acquired several small water companies, several of which were unmetered nor had measurable water production. Hanna stated that establishing rates at the time of acquisition would be difficult as small water utilities and failing water utilities that fall under the State's consolidation requirements carry these issues along with requiring capital improvements. Commission decisions on Del Oro's acquisitions gave Del Oro and the acquired customers one year before changes from prior rates could be made through the GRC process.

Public Comment Session

Public Comment from Ratepayer

A customer commented that their rates would increase over the summer. The customer commented that the way that the existing rules and laws are written encourages the formation of monopolies and openly inquired as to why California legislation established the rules in this way. The commenter acknowledged that the use of the acquisitions process is to further goals regarding the human right to water as well as business' incentives to increase their assets through acquisitions, but the customer expressed concern that ratepayers bear the costs for acquisitions without having a voice in the process. The commenter urged the CPUC to modify the current framework to make it fairer.

Public Comment from Jennifer Lukins – Lukins Brothers Water Company

Jennifer Lukins (Lukins) commented that changes to the gain on sale rules hurt small companies and takes away their earnings. Owners of small companies work extensively to reinvest in their systems, so any returns on a sale should go to them. Class A IOUs are acquirers whereas small IOUs are more interested in selling their systems. Lukins urged the CPUC to analyze the circumstances of water systems that are smaller than East Pasadena Water Company would be beneficial in capturing a larger scope of acquisitions in the water industry.

V. Recommendations to the Commission

Colton recommended that the CPUC should define a standardized scope of outcomes for the acquisition process and should monitor the accomplishment of outcomes to analyze the cost-effectiveness. Acquiring and acquired utilities involved in an acquisition transaction should identify outcomes with respect to improving water quality, equity of service, and affordability of service. The CPUC should determine if outcomes were achieved or not and respond accordingly. Colton also recommended ensuring the transparency of data and information is pertinent to acquisitions. Colton recommended that the CPUC analyze costs and benefits from the angle of cost-effectiveness which measures the effectiveness in accomplishing outcomes. Dolqueist also recommended the development of policy defining options on how decisions are achieved while also defining the different costs between options. Scher recommended that the CPUC discuss with the Class A water utilities to define measurable costs and benefits.

Regarding the ESJ Action Plan, Feldman recommended that the CPUC should be sensitive to DACs, North American Tribes, low-income households, and the intersectionality of those communities. Feldman recommended to expand coordination with: LAFCos for advisory insight and support; Tribal Nations and tribal-designated leaders through consultations to address the impacts of acquisitions; sister water agencies; and minority-focused organizations to expand diversity within the workforce and leadership in the water industry. Feldman advised that the CPUC should review the length of time needed to address problems and needs affecting an acquired system's customers in an acquisition. The CPUC should also examine long-term ratepayer-impacts of acquisitions on existing customers, the scale of the impacts, and if the effects will be permanent or temporary. Pierce recommended that the CPUC improve outreach to customers of the acquiring and acquired system to communicate the benefits of acquisitions.

Chesnutt recommended that the CPUC implement a rate transition period to mitigate impacts to customer bills and to require the sharing of information regarding graduated acquisitions.

Scher recommended that the costs and benefits of an acquisition should be measured and presented in an acquisition application. Currently, applications rely on theoretical benefits. Scher recommended that a revised framework require rate forecasting to be included with the application and that rate changes are implemented with the CPUC approval of the application. Scher recommended that the revised framework should include: the allocation of the gain on sale between the seller of an IOU and the ratepayers of the acquired system; the creation of an associated allocation account to administer the gain on sale via bill sur-credits for the purpose of mitigating rate impacts; and the requirement for the IOU to maintain the acquired system as a separate district until allocated funds are expended.

Dolqueist recommended that the CPUC continue analyzing ratepayer impacts as it has been doing using the information provided in acquisitions applications. This includes impacts to water quality, water service reliability, and expanding the availability of conservation and ratepayer assistance programs. Dolqueist recommended that considerations for rate implementation should be handled in acquiring utilities' GRC and that acquisitions proceedings should not be treated similar to GRCs. Water utilities do not have the costs to operate a consolidated system at the time of application until after the system has been operated. Dolqueist recommended that when the CPUC analyzes ratepayer impacts, it also looks at the scale of likely impacts between the acquiring and acquired utilities' customers.

Lastly, Cal Advocates recommends that the gain on sale rules are applied to acquisitions and that they apply to used and useful assets. Conversely, CWA recommends that the gain on sale rules are not applied to acquisitions and that they only apply to assets that are not used and useful.