STATE OF CALIFORNIA GAVIN NEWSOM, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

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Ratesetting

TO PARTIES OF RECORD IN APPLICATION 23-05-001 ET AL.:

This is the proposed decision of Administrative Law Judge Marcelo Poirier. Until and unless the Commission hears the item and votes to approve it, the proposed decision has no legal effect. This item may be heard, at the earliest, at the Commission's December 5, 2024 Business Meeting. To confirm when the item will be heard, please see the Business Meeting agenda, which is posted on the Commission's website 10 days before each Business Meeting.

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

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

/s/ MICHELLE COOKE
Michelle Cooke
Chief Administrative Law Judge

MLC:smt
Attachment

Decision **PROPOSED DECISION OF ALJ POIRIER** (Mailed 11/4/2024)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Gabriel Valley Water Company (U337W) for an Authorized Cost of Capital for 2024 through 2026.	Application 23-05-001
And Related Matters.	Application 23-05-002 Application 23-05-003 Application 23-05-004

DECISION ADOPTING BASE YEAR 2024 COST OF CAPITAL FOR SAN GABRIEL VALLEY WATER COMPANY, GREAT OAKS WATER COMPANY, SUBURBAN WATER SERVICES AND LIBERTY UTILITIES

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DECISION ADOPTING BASE YEAR 2024 COST OF CAPITAL FOR SAN GABRIEL VALLEY WATER COMPANY, GREAT OAKS WATER COMPANY, SUBURBAN WATER SERVICES AND LIBERTY UTILITIES

Summary

This decision adopts a base year 2024 cost of capital for San Gabriel Valley Water Company, Great Oaks Water Company, Suburban Water Systems and Liberty Utilities Corp. We adopt the ratemaking capital structures, returns on equity, costs of long-term debt and overall rates of return of the three-year period commencing in 2024. We also continue the Water Cost of Capital Mechanism for the same period. In establishing the individualized cost of capital for each water utility, the Commission followed established standards for setting a fair rate of return, considered recent Commission decisions covering the same subject, and exercised judgment based on the specific circumstances of each utility. After consideration, evaluation, and weighing of the record evidence, we have determined this decision is consistent with all Constitutional and statutory requirements.

We adopt the following capital structures, returns on equity, costs of long-term debt, cost of preferred stock and rates of return on rate base.

Table 1

Adopted Capital Structures, Returns on Equity, Costs of Long-Term Debt and Overall Rate of Return

Company	Capital Structure	Return on Equity	Cost of Long-Term Debt	Cost of Preferred Stock	Overall Rate of Return
San Gabriel Valley Water Company	64.95% Common Equity/ 35.05% Long-Term Debt	9.34%	4.99%		7.82%
Great Oaks Water Company	70.00% Common Equity/ 12.70% Actual Long-Term Debt/17.30% Imputed Long-Term Debt	8.78%	6.5%		8.10%
Suburban Water Services	62.00% Common Equity/ 36.69% Long-Term Debt/1.31% Preferred Stock	9.46%	5.03%	4.24%	7.77%
Liberty Utilities Corp.	57.00% Common Equity/ 43.00% Long-Term Debt	9.57%	3.99%		7.17%

The proceeding is closed.

1. Background

On May 1, 2023, pursuant to Commission Decision (D.) 07-05-062, D.18-12-002 as well as an authorized two-year deferral of the cost of capital application deadlines, San Gabriel Valley Water Company (San Gabriel), Great Oaks Water Company (Great Oaks), Suburban Water Systems (Suburban), and

Liberty Utilities Corp. (Liberty)[1] individually filed Applications (A.) 23-05-001, A.23-05-002, A.23-05-003, and A.23-05-004.

The applications of San Gabriel, Great Oaks, Suburban and Liberty (collectively, the Applicants) requested authorized costs of capital over two distinct periods. San Gabriel and Suburban requested an authorized cost of capital for the period from January 1, 2024 through December 31, 2026. Liberty and Great Oaks requested the same authorization for the period from July 1, 2024 through June 30, 2027. The Public Advocates Office of the California Public Utilities Commission (Cal Advocates) filed protests to the applications on June 2, 2023. On June 9, 2023, the presiding Administrative Law Judge (ALJ) consolidated the applications into a single proceeding by ruling. The Applicants filed a joint reply on June 12, 2023 addressing the concerns raised in Cal Advocates' protest. A prehearing conference was held on August 14, 2023. The Assigned Commissioner's Scoping Memo and Order was issued on July 25, 2023.

Cal Advocates served testimony on August 15, 2023. The Applicants served rebuttal testimony on September 5, 2023. On October 12, 2023, the Applicants and Cal Advocates filed a Joint Status Report on Settlement Efforts that indicated that they were unable to reach a settlement and that the Commission should proceed to evidentiary hearings in this proceeding. Evidentiary hearings occurred on October 26 and October 27, 2023. Two remote Public Participation Hearings were held on November 9, 2023. Concurrent opening briefs were filed on November 27, 2023 and concurrent reply briefs were filed on December 18, 2023.

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[1] Liberty includes the Park Water and Apple Valley Ranchos Water systems.

This matter was submitted on December 18, 2023, upon filing of concurrent reply briefs.

2. Jurisdiction

The Commission has jurisdiction over the Applicants pursuant to Public Utilities Code Section 451, which provides:

> Every public utility shall furnish and maintain such adequate, efficient, just, and reasonable service, instrumentalities, equipment, and facilities...as are necessary to promote the safety, health, comfort, and convenience of its patrons, employees, and the public.

Additionally, pursuant to Public Utilities Code Section 454(a), the Commission must find that any rate change by a public utility is justified.

3. Issues Before the Commission

The issues before the Commission in this proceeding are:

1. Whether the Applicants complied with Rule 3.2 and the minimum data requirements outlined in Attachment 2 of the Rate Case Plan?
2. For each Applicant:
    a. What is a just and reasonable rate of return on rate base for the requested period?
    b. What is a reasonable rate of return on common equity for the requested period?
    c. What is a reasonable weighted average cost of debt for the requested period?
    d. What is a reasonable capital structure for the requested period?
    e. Whether it is appropriate to continue the Water Cost of Capital Mechanism (WCCM) for the requested period using 2024 as the base year?

Issue 1 was not contested, and the Applicants have shown that they have complied with Rule 3.2 and the minimum data requirements outlined in Attachment 2 of the Rate Case Plan.[2] The remaining issues are addressed below.

4. Capital Structure

Ratemaking capital structure consists of common equity, long-term debt and preferred stock. Since the level of financial risk that utilities face is based in part on their capital structure, the Commission must ensure that the utilities' adopted capital structure is sufficient to maintain reasonable credit ratings and attract capital while also ensuring there are adequate ratepayer protections regarding the costs of the capital structure components.

Generally, long-term debt is the least expensive form of capital, but the utility must ensure that it timely meets every interest payment and maintains any required terms or conditions of the loan agreements or mortgage indentures, and that it can refinance or refund the long-term debt when it matures. Preferred stock is generally more expensive than long-term debt and may or may not have a maturity or refund provision. Interest may usually be deferred, but it then accumulates and takes preference over payment of dividends to common equity owners. Thus, common equity owners assume more risk than either long-term debt holders or preferred stock owners, including the risk of losing their entire investment, and therefore common equity investors require the highest return over the long run.

The capital structures of the Applicants consist of common equity, long-term debt and preferred stock. The capital structure proposed by San Gabriel

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[2] Proof of Compliance with Notice Requirements of Rule 3.2 of San Gabriel, June 12, 2023; Proof of Compliance with Rule 3.2 of Great Oaks, July 13, 2023; Rule 3.2 Compliance Filing of Suburban, May 30, 2023; Rule 3.2 Compliance Filing of Liberty, June 21, 2023.

and Great Oaks are unopposed. However, Cal Advocates opposes the capital structures proposed by Suburban and Liberty. The positions of the Applicants and Cal Advocates are summarized below.

Table 2

Proposed Capital Structures of the Applicants and Cal Advocates

	Utility	Cal Advocates
San Gabriel	64.95% common equity/ 35.05% long-term debt	64.95% common equity/ 35.05% long-term debt
Great Oaks	70.00% common equity/ 12.70% actual long-term debt/17.30% imputed long-term debt	70.00% common equity/ 12.70% actual long-term debt/17.30% imputed long-term debt/
Suburban	62.00% common equity/ 36.69% long-term debt/1.31% preferred stock	58.38% common equity/39.6% long-term debt/1.96% preferred stock
Liberty	57.00% common equity/ 43.00% long-term debt	46.13% common equity/ 53.87% long-term debt

We address the Applicants' proposed capital structure requests below.

4.1. San Gabriel Valley Water Company

San Gabriel requests Commission approval of a capital structure of 64.95 percent common stock equity and 35.05 percent long-term debt.[3] Cal Advocates does not oppose San Gabriel's proposed capital structure.[4] We find that the unopposed capital structure proposed by San Gabriel is reasonable and adopt it.

[3] A.23-05-001 at 2 to 3.

[4] Cal Advocates Opening Brief at 6.

4.2. Great Oaks

Great Oaks requests Commission approval of a capital structure of 70 percent common equity, 12.70 percent actual long-term debt and 17.30 percent imputed long-term debt.[5] Imputed long-term debt results from an adjustment to a company's capital structure to increase the proportion of long-term debt. Imputing additional long-term debt in Great Oaks' regulatory capital structure is intended as a proxy to reflect the impact on rates of an increasing proportion of long-term debt over a several-year time period.[6] Cal Advocates does not oppose Great Oaks's requested capital structure.[7] We find that the unopposed requested capital structure proposal by Great Oaks is reasonable and grant its approval.

4.3. Suburban

Suburban requests a capital structure of 62 percent common equity, 36.69 percent long-term debt and 1.31 percent preferred stock.[8] Cal Advocates opposes Suburban's proposed capital structure, arguing that the Commission should adopt a capital structure of 58.38 percent common equity, 39.60 percent long-term debt and 1.96 percent preferred stock.[9]

Suburban asserts that its proposed capital structure is reasonable and that the proposed ratios are consistent with its previous cost of capital proceeding, reflect its anticipated debt and equity issuances and are compatible with the five-year historical average in the last cost of capital proceeding.[10] Suburban argues

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[5] *Ibid*.

[6] Great Oaks Opening Brief at 6.

[7] *Id*. at 7.

[8] Suburban Opening Brief at 42.

[9] Cal Advocates Opening Brief at 7.

[10] Suburban Opening Brief at 42.

that Cal Advocates' recommended capital structure is unreasonable because it is: (1) based upon applying incorrect data and (2) contrary to Commission precedent.[11]

First, Suburban contends that Cal Advocates errs in relying upon Suburban's audited financial statements for its capital structure recommendation and instead should rely on Suburban's annual reports. Suburban states that the annual reports are the appropriate data source because these reports are prepared based on the Uniform System of Accounts for Class A Water Utilities (USOA), while audited financial statements are prepared using Generally Accepted Accounting Principles (GAAP).[12] It argues that although there are some similarities, "annual reports and audited financial statements are different documents used for different purposes and are not interchangeable."[13] Suburban also emphasizes that it is required to use USOA for ratemaking purposes, including the determination of an appropriate capital structure. It contests Cal Advocates' allegations of "discrepancies" between the audited financial statements and the annual reports, arguing that any differences result from the disparate accounting treatment of certain areas by USOA and GAAP.[14]

Second, Suburban asserts that Cal Advocates' reliance solely upon historical data is inconsistent with the Water Rate Case Plan.[15] It indicates that the Commission requires the use of a forecasted test year because it "allows the utility to project expected costs and determine the revenue required to recover

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[11] *Ibid*.

[12] *Ibid*.

[13] *Ibid*.

[14] *Id*. at 43.

[15] *Ibid*.

those costs, and the Commission to tailor the rate changes to match anticipated cost changes."[16] Suburban also cites to D.23-06-023, the most recent decision as to the cost of capital for the large Class A water utilities, which rejected the reliance on historical data "if it does not also include adjustments for known or foreseeable future events."[17] Suburban contends that Cal Advocates did not analyze whether the historical data would be sufficient to meet Suburban's future needs and included no adjustments to address known or foreseeable future events.

Cal Advocates argues that its proposed capital structure is appropriate because it considers recent Suburban capital structures and the outcomes of the usage of those structures.[18] It bases its proposed capital structure on a five-year average of historical data from Suburban's audited financial statements, which it asserts "provides a more accurate overview of [Suburban's] actual capital structure" and addresses past overestimates of the equity component in the capital structure.[19] Cal Advocates contends that the five-year average shows that Suburban can carry more debt in its capital structure.

Additionally, Cal Advocates alleges there are "critical discrepancies" between the debt and equity amounts in Suburban's annual reports as compared to the audited financial statements from 2018 to 2022.[20] Cal Advocates claims that since Suburban has not adequately reconciled these discrepancies in this

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[16] *Ibid*.

[17] D.23-06-023 at 37.

[18] Cal Advocates Opening Brief at 7.

[19] *Id*. at 8.

[20] *Ibid*.

proceeding, the Commission should adopt Cal Advocates' recommended capital structure because it more accurately reflects Suburban's historic capital structure.

We find that Suburban's proposed capital structure of 62 percent common equity, 36.69 percent long-term debt and 1.31 percent preferred stock is reasonable. The capital structure proposed by Suburban is relatively consistent with its last adopted capital structure.[21] Additionally, the methodology used by Suburban to establish its proposed capital structure is consistent with the Water Rate Case Plan in that it does not rely solely on historical data. As indicated in D.23-06-023, the forecast methodology allows for adjustments for known or foreseeable future events.[22] Lastly, we do not find persuasive evidence that the alleged "discrepancies" between Suburban's audited financial statements and the annual reports is cause for not adopting its requested capital structure. Therefore, we adopt the capital structure proposed by Suburban.

4.4. Liberty

Liberty requests a capital structure of 43 percent long-term debt and 57 percent common stock equity.[23] Cal Advocates opposes Liberty's proposed capital structure, arguing that the Commission should approve its recommended capital structure of 53.87 percent long-term debt and 46.13 percent equity.[24]

Liberty argues that the record supports its proposed capital structure, indicating it is based on its average estimated capital structure for 2024 to 2026 and incorporates additional debt and equity transactions completed during

[21] D.18-12-002 at Appendix A.

[22] Suburban Opening Brief at 43.

[23] Liberty Opening Brief at 19.

[24] Cal Advocates Opening Brief at 9.

2023.[25] It asserts that, as of the date of this submission, its capital structure consists of 42 percent long-term debt and 58 percent common equity and that its proposed capital structure for the relevant period is appropriately adjusted for known and foreseeable future events.[26] Liberty contends that Cal Advocates' proposed capital structure is inappropriately based upon historic debt and equity balances from 2018 to 2022.[27] It argues that Cal Advocates' use of historic debt and equity balances is misplaced because its capital structure was 100 percent equity until 2022 and only changed to 43 percent long-term debt and 57 percent common equity following Commission approval of up to $51.5 million in long-term debt.[28] Liberty contends that Cal Advocates' methodology ignores what its actual capital structure will be from 2024 to 2026.

Liberty also asserts that D.23-06-025 found the forecast methodology produced a more reasonable result because it includes adjustments for known and foreseeable events.[29] It also states its requested capital structure is consistent with its previously approved capital structures.[30] Liberty contends that the Commission should ignore Cal Advocates' argument that Liberty's proposed capital structure is not supported by data and calculations and cites to data responses and testimony in the record that support its proposal.[31]

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[25] Liberty Opening Brief at 19.

[26] *Ibid*.

[27] *Id*. at 20.

[28] Liberty Opening Brief at 20; Exh. LIB-1 (Rao Direct) at 3; Exh. LIB-3 (Rao Rebuttal) at 1.

[29] Liberty Opening Brief at 20; D.23-06-025 at 36.

[30] D.10-10-035, D.13-05.027, and D.20-01-009.

[31] Liberty Reply Brief at 3.

Cal Advocates' proposed capital structure for Liberty is based on a historic average of debt and equity in Liberty's annual reports data from 2018 to 2022. It argues that Liberty failed to provide data or calculations to adequately support its requested cost of capital so a historic average is appropriate because it is based on Liberty's actual capital structure data provided in the annual report from 2018 to 2022.[32] Cal Advocates asserts its proposed capital structure more closely aligns "with the Commission's goal of preventing equity-rich structures and would be more beneficial for ratepayers."[33] It also argues that Liberty has not demonstrated that its proposed capital structures would impede the ability to attract capital and maintain existing credit ratings.

We find that Liberty's requested capital structure of 57 percent common equity and 43 percent long-term debt is reasonable. The methodology used by Liberty is consistent with the Water Rate Case Plan and guidance provided in D.23-06-025, which found that the forecast methodology produced a more reasonable result. We also note that the percentage of common equity requested by Liberty is the lowest of the four Applicants by a significant margin, including those unopposed by Cal Advocates. Lastly, it is also persuasive that Liberty's proposed capital structure is consistent with the approved capital structures for Liberty in the four previous Commission decisions. Therefore, we adopt the capital structure proposed by Liberty.

4.5. Summary of Adopted Capital Structures

The adopted capital structures are shown below.

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[32] Cal Advocates Opening Brief at 9-10.

[33] *Ibid*.

Table 3

Adopted Capital Structures

San Gabriel	64.95% common equity/35.05% long-term debt
Great Oaks	70.00% common equity/12.70% actual long-term debt/17.30% imputed long-term debt
Suburban	62.00% common equity/ 36.69% long-term debt/1.31% preferred stock
Liberty	57.00% common equity/43.00% long-term debt

5. Return on Equity

In a competitive market, a return on equity is determined by the relative risks of alternative investments and the willingness of investors to accept varying degrees of risk.[34] In a closely regulated market, regulation substitutes for competition and the regulator, acting as a substitute for the market, provides investors an opportunity to earn a fair and reasonable return for accepting the degree of risk presented by the regulated business.

The legal standard for setting the fair rate of return was established by the United States Supreme Court in the *Bluefield*,[35] *Hope*,[36] and *Duquesne* cases.[37] *Bluefield* finds that a utility's overall return should be comparable to the overall return earned at the same time and in the same general part of the country on investments in other business undertakings attended by corresponding risks and

[34] D.10-10-035 at 27.

[35] *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923) (*Bluefield*).

[36] *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944) (*Hope*).

[37] *Duquesne Light Company v. Barasch*, 488 U.S. 299 (1989) (*Duquesne*).

uncertainties.[38] *Hope* states that authorized rates will not be judged invalid as long as they enable a utility to: (1) maintain financial integrity, (2) attract capital, and (3) compensate investors for the risks they assume.[39] *Duquesne* concludes that rates must not be so low as to be confiscatory.[40] In applying these parameters, the Commission must also protect ratepayers from unreasonable risks including risks of imprudent management.[41] The Commission need not use a particular methodology in applying the Constitutional standard, as long as it allows the utility a reasonable opportunity to earn a fair return on investments.[42]

Therefore, the Commission's core objective in a cost of capital proceeding is to set the return on equity return at a level of return commensurate with market returns on investments having corresponding risks, and adequate to enable a utility to attract investors to finance the replacement and expansion of a utility's facilities to fulfill its public utility service obligation. [43] To accomplish this objective, the Commission has consistently evaluated financial models as a starting point to arrive at a fair return on equity.

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[38] *See Bluefield* at 692-693.

[39] *See Hope* at 603-605.

[40] *See Duquesne* at 307-308.

[41] *See e.g.*, *Missouri ex rel. Southwestern Bell Telephone Co. v. Missouri Public Service Commission*, 262 U.S. 276, 289 n.1 (1924) (Brandeis, J., concurring). *See also*, Pub. Util. Code § 451.

[42] Pub. Util. Code § 701.10(a). *See also, Duquesne* at 317 (Scalia, J., concurring, joined by White and O'Connor, JJ.).

[43] 46 CPUC2d 319 at 369 (1992).

5.1. Financial Models

There are various financial models commonly used in equity return proceedings, including the Discounted Cash Flow Analysis (DCF),[44] the Risk Premium Model (RPM),[45] and the Capital Asset Pricing Model (CAPM).[46] The financial models establish a range of returns on equity to consider in selecting the an authorized return and evaluate trends of investor expectations.[47] The Commission has not adopted a single preferred financial model because no model is perfect, and the results produced by the models are susceptible to various input assumptions.

Therefore, the Commission has historically reviewed an array of financial models with varied assumptions before exercising its judgment in adopting a return on equity.[48] Furthermore, the financial models used in the Commission's cost of capital proceedings are not determinative and must be tempered with a great deal of judgment. The DCF, RPM, and CAPM cannot be relied upon exclusively to estimate an exact cost of equity but may be helpful in developing a range of reasonable values.

We note that several of the Applicants conducted analysis with variations of the financial models listed above and also used alternative models. Liberty conducted analysis with variations of the CAPM, including the Empirical

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[44] The DCF model is used to estimate an equity return from a proxy group by adding estimated dividend yields to investors expected long-term dividend growth rate.

[45] Similar to the CAPM, the RPM measures a company's cost of equity capital by adding a risk premium to a risk-free long-term treasury or utility bond yield.

[46] The CAPM is a risk premium approach that gauges an entity's cost of equity based on the sum of an interest rate on a risk-free bond and a risk premium.

[47] D.09-05-019 at Finding of Fact 10.

[48] D.09-05-019 at 15.

CAPM[49] and the Modified CAPM.[50] San Gabriel and Great Oaks also utilized the Empirical CAPM.[51] Suburban conducted a comparable earnings analysis.[52] Cal Advocates utilized the CAPM and two DCF methods, constant growth and non-constant growth.[53]

5.1.1. Proxy Groups

The DCF and CAPM financial models use a proxy group comprised of companies with characteristics and risks comparable to those of the Applicants. The Applicants and Cal Advocates selected their proxy groups based on several criteria, including that the company: (1) is a publicly traded water utility; (2) has an investment grade bond rating; (3) has a high percentage of revenue from regulated activities; (4) is included in the Water Utility Group of Value Line; (5) has a Value Line adjusted beta; (6) has not cut or omitted its common dividends during the five years prior to April 2023; and (7) has five or more years of available data; and (8) has not experienced significant merger activity in the previous five years.[54] The Applicants and Cal Advocates used different combinations of the above criteria to select their respective proxy groups.

Although the Applicants and Cal Advocates used several different proxy groups in their core analysis, the following six companies were included

[49] Liberty Opening Brief at 10. The Empirical CAPM modifies the formula to address that estimates of the risk-free rate are higher than the return on long-term Treasury bonds. The Modified CAPM includes a size premium.

[50] Liberty Opening Brief at 10. Liberty indicates that these variations better account for the higher risks associated with smaller companies.

[51] San Gabriel Opening Brief at 44; Great Oaks Opening Brief at 16.

[52] Suburban Opening Brief at 24.

[53] Exh. CalAdv-02 at 44.

[54] San Gabriel Opening Brief at 6; Great Oaks Opening Brief at 14; Exh. SWS-01 at schedule 3; Liberty Opening Brief at 6; Exh. CalAdv-02 at 46.

in all proxy groups: (1) American States Water, (2) American Water Works, (3) Essential Utilities, (4) California Water Company, (5) Middlesex Water and (6) SJW Corp. San Gabriel and Cal Advocates limited its proxy group to these six companies.[55] Great Oaks and Liberty also included York Water Company[56], while Suburban included both York and Artesian Resources Corp.[57] Several of the Applicants used alternative proxy groups for additional analyses. Great Oaks included Artesian Resources and Global Water Resources in its "expanded sample" group. San Gabriel applies the financial models to a non-regulated proxy group of 20 companies.[58]

5.1.2. Adjustments

Several of the Applicants and Cal Advocates included adjustments to their cost of equity financial modeling results to reflect a variety of risks due to differences between the Applicants and the proxy groups.

San Gabriel includes a net upward adjustment of six basis points to reflect specific business and financial risks due to differences between San Gabriel and its proxy group. San Gabriel's net upward six basis point adjustment is the result an analysis of various risk factors.

San Gabriel first proposes an upward adjustment of 30 basis points to account for its smaller size and increased business risk relative to the proxy group. It argues that smaller companies face higher risk because they generally have more difficulty dealing with significant events that affect sales, revenues,

[55] San Gabriel Opening Brief at 7; Exh. SG-1 at 15; Cal Opening Brief at 14; Exh. CalAdv-2 at 10 to 11.

[56] Great Oaks Opening Brief at 15; Exh. GOW-1 at 26; Liberty Opening Brief at 6; Exh. LIB-2 at 13.

[57] Suburban Exh. SWS-1 at Schedule 3.

[58] Great Oaks Opening Brief at 7; San Gabriel Opening Brief at 15.

and earnings. San Gabriel also emphasizes that it is "uniquely and adversely affected by contaminants in its water supplies" because a significant portion of its water supply is located within or near several Environmental Protection Agency (EPA) Superfund cleanup sites, which could potentially require a significant amount of capital to address.[59]

San Gabriel then proposes an offsetting downward return on equity adjustment of 24 basis points to reflect its lower financial risk relative to the proxy group.[60] The downward adjustment is intended to reflect the lower financial risk related to San Gabriel's proposed capital structure ratio as compared to that of the proxy group. The downward adjustment is the average of two methods for quantifying the financial risk for a company.[61]

Great Oaks does not propose a specific adjustment but notes that the Commission has considered the specific risks for a water utility when determining a return on equity and has authorized adjustments to reflect those risks. Great Oaks points to its small size (21,400 connections) and high percentage of residential connections (92 percent) as risk factors.[62] It emphasizes that it is more impacted by water conservation restrictions due to its high percentage of large residential connections. Great Oaks notes that its reliance on a single water source and the potential impacts of climate change as a risk factors.[63] Lastly, Great Oaks cites additional regulatory risks, including the "strain" caused by different state agency reporting requirements.

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[59] San Gabriel Opening Brief at 16 to 19.

[60] *Ibid*.

[61] *Id*. at 19 to 20.

[62] Great Oaks Opening Brief at 22 to 24.

[63] *Id*. at 23 to 25.

Suburban does not propose specific adjustments other than an upward adjustment of 102 basis points to its CAPM.[64] However, it emphasizes that Commission should consider various risks in its general deliberation on the appropriate return on equity for Suburban because investors require increased returns to compensate for these risks.[65]

Suburban asserts it faces risks that are unique to water utilities, including higher compliance costs and legal exposure from regulatory actions, water quality risks, a relatively high degree of capital intensity and fixed costs, customer conservation and cybersecurity concerns.[66] It also indicates that it faces unique risks as a utility operating in California, including that new state regulations could be more stringent than federal regulations, which could increase compliance costs.[67] Lastly, Suburban contends that it faces unique risks that are distinguishable from other water utilities in California, including the other Class A water utilities.[68] It points to the substantial amount of upcoming capital expenditure due to the age of existing infrastructure as well as its "substantially" smaller size compared to other water utilities.[69] Suburban also cites to the vulnerability of a majority of its water supply, indicating that its heavy reliance on groundwater is threatened by drought and overdraft of groundwater supplies by other users in the area. It also identifies several other

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[64] Exh. SWS-01 at 46.

[65] Suburban Opening Brief at 9.

[66] *Id*. at 9 to 12.

[67] *Id*. at 12 to 13.

[68] *Id*. at 13 to 15.

[69] *Id*. at 9.

risks, including water contamination issues, its quantity of Asbestos Concrete pipe and other regulatory issues.[70]

Liberty includes a 20 basis point upward adjustment to its model results based on conducting a risk study that incorporated metrics correlated with size and risk.[71] It argues that the adjustment is reasonable based on the specific characteristics, including: (1) it is not publicly traded (2) its equity lacks investment liquidity and (3) its smaller size.[72] Liberty emphasizes that its smaller size "translates into a higher level of risk due to multiple elements, including limited revenue and cash flow, comparatively smaller and limited customer base, and higher earnings volatility."[73]

Cal Advocates argues that risk adjustments requested by the Applicants are not substantiated and should be rejected. Cal Advocates asserts that the record does not demonstrate that investors require a higher return for smaller water utilities.[74] Cal Advocates cites to evidence that a small firm premium is inappropriate since size is not a fundamental factor of a company. Cal Advocates also contends that many state commissions, including California, have not authorized a higher return on equity for companies based on a smaller size.[75]

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[70] *Id*. at 14.

[71] Liberty Opening Brief at 12. Liberty also identifies other applicable risks, including financial risk, regulatory risk and operational risk.

[72] *Ibid*

[73] *Ibid*.

[74] Cal Advocates Opening Brief at 28.

[75] Exh. CalAdv-2 at 105; Cal Advocates Opening Brief at 29.

5.1.3. Financial Model Results

Although the models are objective, the results are dependent on subjective inputs. Each party utilized different subjective inputs to arrive at their DCF and CAPM financial model result. Therefore, the financial model results are not based on consistent subjective inputs, which results in considerable variation in the proposed model results presented by each party. The parties' financial model results are summarized below.

Table 4

Financial Model Results

	San Gabriel[76]	**Great Oaks**[77]	**Suburban**[78]	**Liberty**[79]	**Cal Advocates**[80]
DCF	9.19%	8.76% - 9.75%	10.73%	9.80%	5.63% - 8.09%
RPM	12.11%	10.00%	11.76%	11.60%	
CAPM	11.82%	8.50% - 10.00%	15.43%	10.70%	7.06% - 8.22%
Comparable Earnings			12.20%		

The financial models used by the Applicants produced costs of equity ranging from 8.75 percent to 15.43 percent, while Cal Advocates' financial models produced costs of equity between 5.63 percent and 8.22 percent. The

[76] San Gabriel Opening Brief at 5 to 21 (results reflect a net six basis point adder).

[77] Great Oaks Opening Brief at 25.

[78] Suburban Opening Brief at 17.

[79] Liberty Opening Brief at 6 (results reflect a 20 basis point adder).

[80] Exh. CalAdv-2 at 11 (based on constant growth and non-constant growth analyses).

parties applied risk factors and individual informed judgment to the results of the financial models to establish a range of proposed returns on equity. The Applicants then used the established ranges to derive a proposed return on equity, ranging from a low of 9.7 percent by Great Oaks to a high of 11.0 percent by Suburban. Cal Advocates proposes a return on equity of 7.44 percent for San Gabriel, Great Oaks and Suburban, but proposes 7.62 percent for Liberty.

Table 5 summarizes the parties' proposed return on equity ranges and the specifically proposed return on equity.

Table 5

Return on Equity Proposals of the Applicants and Cal Advocates

	Proposed Return on Equity Range		**Proposed Return on Equity**	
	Applicant	**Cal Advocates**	**Applicant**	**Cal Advocates**
San Gabriel	10.15% - 11.15%	6.84% - 8.04%	10.65%	7.44%
Great Oaks	8.75% - 10.0%	6.84% - 8.04%	9.70%	7.44%
Suburban	10.73% - 15.43%	6.84% - 8.04%	11.0%	7.44%
Liberty	9.75% - 11.60%	7.02% - 8.22%	10.80%[81]	7.62%[82]

[81] Includes a 20 basis point risk premium due to small size of utility.

[82] Includes an 18 basis point risk premium due to capital structure.

Cal Advocates asserts that its proposed ranges for return on equity are consistent with the returns on equity sought by investors and "would enable the Applicants to raise the capital needed to provide safe and reliable service."[83] The Applicants assert that Cal Advocates' proposed returns on equity are too low given several factors, including recent developments as to the returns on equity for the four large Class A water utilities.[84]

Since the issuance of D.23-06-025, the WCCM has been triggered twice, leading to the four large Class A water utilities filing advice letters requesting increases in their respective costs of equity. The WCCM is intended to adjust the return on equity – both upward and downward – to reflect changes in capital markets between the triennial cost of capital filings. The WCCM should only be triggered when there are substantial changes in the capital markets as shown in the yields of utility bonds.

The Commission approved all of the WCCM Advice Letters, resulting in an approximately 120 basis point increase above the returns on equity approved in D.23-06-025. The changes in the returns on equity are summarized in the table below.

[83] Cal Advocates Opening Brief at 19.

[84] The four large class A water utilities are: California-American Water Company (Cal-Am), California Water Service Company (Cal Water), Golden State Water Company (Golden State), and San Jose Water Company (San Jose Water).

Table 6

Large Class A Water Utilities' Authorized Returns on Equity

The Applicants argue that the returns on equity currently authorized for the large Class A water utilities subsequent to the triggering of the WCCM

	Previously Authorized Return on Equity	**Return on Equity Authorized in D.23-06-025**	**Authorized Return on Equity After WCCM Trigger No. 1**[85]	**Authorized Return on Equity After WCCM Trigger No. 2**[86]
California American Water Company	9.20%	8.98%	9.50%	10.20%
Golden State Water Company	8.90%	8.85%	9.36%	10.06%
California Water Service Company	9.20%	9.05%	9.57%	10.27%
San Jose Water Company	8.90%	8.80%	9.31%	10.01%

underscore ongoing trends in the capital markets, including increasing interest rates. They assert that these market trends call for higher authorized

[85] *See* Cal-Am Advice Letter 1415, filed on June 30, 2023 and effective on July 31, 2023; Golden State Water Advice Letter 1897-W, filed on June 30, 2023 and effective on July 31, 2023; Cal Water Advice Letter 2485 filed on June 30, 2023 and effective on July 30, 2023; San Jose Water Advice Letter 598 filed on June 30, 2023 and effective on July 31, 2023.

[86] *See* Cal-Am Advice Letter 1424, filed on October 16, 2023 and effective on January 1, 2024; Golden State Water Advice Letter 1910-W, filed on October 12, 2023 and effective on January 1, 2024; Cal Water Advice Letter 2495 filed on October 13, 2023 and effective November 13, 2023; San Jose Water Advice Letter 601 filed on October 13, 2023 and effective on January 1, 2024.

returns on equity than were authorized in D.23-06-025 or proposed by Cal Advocates.[87]

Cal Advocates argues that the triggering of the WCCM for the four large Class A water utilities does not justify a higher return on equity. It asserts that the purpose of this proceeding is to determine the Applicants' returns on equity based on current capital market data and that the triggering of the WCCM for the four large Class A water is not relevant to this proceeding.[88] Cal Advocates also contends that even though inflation has increased, the stability of utilities' returns during capital market uncertainty makes their stocks more attractive to investors. Cal Advocates indicates that this attractiveness would likely decrease the necessary return on equity.[89]

5.2. Adopted Return on Equity

Precisely determining a perfectly exact cost of equity is not realistic, so the Commission relies on the wide ranges of the models and our best judgment to fulfill our regulatory obligation of adopting a just and reasonable return on equity. In the final analysis it is the application of judgment, not the precision of the models, which is the key to selecting a specific equity return. After considering the evidence on the ongoing uncertainty of market conditions and trends, creditworthiness, interest rate forecasts, quantitative financial models, additional risk factors, size and access to the financial markets, recent regulatory developments and by applying our informed judgment, we find a return on equity within the range of 8.22 percent and 11.52 percent is fair and reasonable.

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[87] San Gabriel Opening Brief at 32-34; Great Oaks Opening Brief at 12-13; Suburban Opening Brief at 5-7; Liberty Opening Brief at 1-20; Exh. SWS-5 at 2-4; Exh. SWS-6 at 2-4; Exh. SWS-7 at 2 to 4; Exh. SWS-8, pp. 2-3.

[88] Cal Advocates Reply Brief at 7.

[89] *Ibid*.

None of the parties have provided persuasive evidence that justifies that a result from the upper and lower ranges would be reasonable. Therefore, we have selected return on equity figures more in the middle of that range.

We do not include any company-specific premiums. None of the Applicants provided persuasive evidence for an additional premium over a market return on equity due to risk. We find that the variations in size, equity ratio, and operational differences amongst the Applicants cannot be precisely calculated to derive a numeric adjustment to this return. Additionally, the potential risks identified by the Applicants are already adequately reflected in the various financial models.

5.3. San Gabriel Return on Equity Summary

San Gabriel's proposed return on equity of 10.65 percent exceeds its currently authorized 9.20 percent of return on equity but is within the 8.22 percent to 11.52 percent return on equity range found reasonable in this proceeding. After applying informed judgment and considering the evidence on the above factors, market conditions, trends, interest rate forecasts, quantitative financial models based on subjective inputs, specific risks presented by San Gabriel, as well as its capital structure, we find that a 9.34 percent return on equity is fair and reasonable for San Gabriel.

5.4. Great Oaks Return on Equity Summary

Great Oaks' proposed return on equity of 9.70 percent exceeds its currently authorized 8.85 percent of return on equity but is within the 8.22 percent to 11.52 percent return on equity range found reasonable in this proceeding. After applying informed judgment and considering the evidence on the above factors, including market conditions, trends, interest rate forecasts, quantitative financial models based on subjective inputs, specific risks presented by Great Oaks, as well as its capital structure, we find that an 8.78 percent return on equity is fair and reasonable for Great Oaks.

5.5. Suburban Return on Equity Summary

Suburban's proposed return on equity of 11.0 percent exceeds its currently authorized 9.25 percent return on equity but is within the 8.22 percent to 11.52 percent return on equity range found reasonable in this proceeding. After applying informed judgment and considering the evidence on the various factors, including market conditions, trends, interest rate forecasts, quantitative financial models based on subjective inputs, specific risks presented by Suburban, as well as its capital structure, we find that a 9.46 percent return on equity is fair and reasonable for Suburban.

5.6. Liberty Return on Equity Summary

Liberty's proposed return on equity of 10.8 percent exceeds its currently authorized 9.35 percent return on equity, but is within the 8.22 percent to 11.52 percent return on equity range found reasonable in this proceeding. After applying informed judgment and considering the evidence on the above factors, including market conditions, trends, interest rate forecasts, capital structures, quantitative financial models based on subjective inputs and specific risks presented by Liberty, as well as its capital structure, we find that a 9.57 percent return on equity is fair and reasonable for Liberty.

5.7. Summary of Adopted Returns on Equity

The adopted returns of equity for each Applicant are shown below.

Table 7

Adopted Returns on Equity

San Gabriel	9.34%
Great Oaks	8.78%
Suburban	9.46%
Liberty	9.57%

6. Cost of Long-Term Debt

Long-term debt and preferred stock costs are based on actual, or embedded costs. The future cost of long-term debt must be anticipated to reflect projected changes in a utility's cost caused by the issuance and retirement of long-term debt and preferred stock during the year since the rate of return is established on a forecast basis. Despite the variance of actual interest rates, the Commission's task is to determine "reasonable" long-term debt cost rather than actual cost based on an arbitrary selection of a past figure. In this regard, the latest available interest rate forecast should be used to determine the forecast of additional debt included in the embedded debt for the forecast period.

Cal Advocates does not oppose the proposed costs of long-term debt for Suburban and Liberty, but it opposes the proposals of San Gabriel and Great Oaks. The costs of long-term debt proposed by the Applicants and Cal Advocates are shown below in Table 8.

Table 8

Comparison of Proposed Cost of Long-Term Debt

	Applicant	**Cal Advocates**
San Gabriel	4.99%	4.93%
Great Oaks	6.50% Actual 7.50% Imputed	6.50% Actual 6.07% Imputed
Suburban	5.03%	5.03%
Liberty	3.99%	3.99%

6.1. San Gabriel

San Gabriel proposes a cost of long-term debt of 4.99 percent based on an average of the forecasted embedded costs of long-term debt for years 2024, 2025, and 2026, which is the period at issue in this proceeding.[90] Cal Advocates proposes a cost of long-term debt of 4.93 percent based on a four-year average of long-term debt cost from 2023 through 2026 average.[91] While San Gabriel and Cal Advocates agree on San Gabriel's use of the forecasted annual embedded cost of long-term debt applicable to each of the years 2024 through 2026, they disagree on the appropriateness of including 2023 data in the calculation.

San Gabriel asserts that its methodology is consistent with what both San Gabriel and Cal Advocates used in A.18-05-005, the previous cost of capital proceeding. It emphasizes that the Commission recently found that this methodology "produces the most reasonable result for calculating the resulting cost of capital."[92] San Gabriel asserts that Cal Advocates' inclusion of 2023 data to calculate San Gabriel's forecasted cost of long-term debt is "unsound" because 2023 is not relevant to the average cost of long-term debt for the 2024 through 2026 cost of capital cycle.[93] San Gabriel also contends that Cal Advocates has provided no evidence to support its use of 2023 data, while it has provided evidence based on financial forecasts and insurance company evaluations that its cost of long-term debt will actually increase in 2024 through 2026.[94]

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[90] San Gabriel Opening Brief at 35.

[91] Cal Advocates Opening Brief at 12.

[92] D.23-06-025 at 32 to 33.

[93] San Gabriel Opening Brief at 36.

[94] *Id*. at 37.

Cal Advocates argues that calculating its proposed cost of long-term debt of 4.93 percent using a four-year average of forecasted cost of long-term debt instead of three years is reasonable. Cal Advocates contends that the inclusion of the 2023 data results in a more accurate weighted average of the cost of long-term debt.[95] It asserts that the 2023 data is not historical and therefore appropriate to use, and that San Gabriel has not provided a reasonable rationale for excluding the data.

We find that San Gabriels' requested 4.99 percent cost of long-term debt is reasonable. San Gabriel's methodology is consistent with the methodology used by both San Gabriel and Cal Advocates used in A.18-05-005, the previous cost of capital proceeding, as well as D.23-06-023's finding that the forecast methodology produces the most reasonable result. Therefore, we authorize a cost of long-term debt of 4.99 percent for San Gabriel.

6.2. Great Oaks

Great Oaks requests that the Commission adopt a 6.50 percent cost of actual long-term debt and a 7.50 percent cost of imputed long-term debt.[96] While Cal Advocates agrees with the cost of actual long-term debt, it opposes the cost of imputed long-term debt proposed by Great Oaks. Instead, Cal Advocates proposes a cost of imputed long-term debt of 6.07 percent.[97]

Great Oaks contends that the goal of imputing debt in its regulatory capital structure is to provide a proxy for the impact on rates of complementing existing debt with additional long-term borrowing over a period matching the

[95] Cal Advocates Opening Brief at 12.

[96] Great Oaks Opening Brief at 6.

[97] Cal Advocates Opening Brief at iv.

expiration of existing long-term debt in 2028.[98] Great Oaks asserts its proposed cost imputed long-term debt of 7.5 percent is reasonable because it reflects its "current cost of borrowing at a maturity of [five] years or longer."[99] It argues that although its proposed cost of imputed long-term debt would provide a premium above Moody's Baa bond index standards at the time of application filing, rate increases since that filing have significantly reduced that premium. Great Oaks also claims the premium is reasonable given market realities and is lower than premiums approved for Great Oaks by the Commission in the past.[100]

Great Oaks also characterizes Cal Advocates' recommended cost of imputed long-term debt methodology as "flawed" because it relies on the long-term debt costs of other companies in this proceeding and is not based on an analysis of Great Oaks' specific risk profile or borrowing costs. Great Oaks emphasizes that its proposed cost is based on a "thorough analysis of the proposed imputed [long-term] debt cost in the context of the current capital market conditions" and is consistent with prior Commission approval of the same 7.5 percent cost of imputed long-term debt for Great Oaks.[101]

Cal Advocates argues that Great Oaks' proposed cost of imputed long-term debt of 7.5 percent is excessive and based on "Commission decisions from over a decade ago that were issued in very different economic environments, which no longer apply today."[102] It emphasizes that all of the other Applicants in this proceeding "propose forecasted debt cost using Blue Chip census forecasts

[98] Great Oaks Opening Brief at 6.

[99] *Id*. at 7.

[100] *Ibid*.

[101] Great Oaks Opening Brief at 7.

[102] Cal Advocates Opening Brief at 13.

of long-term Treasury rate and Moody's corporate spreads for utilities," resulting in lower forecasted long-term debt costs than proposed by Great Oaks.[103] Based on these rates, Cal Advocates asserts there is no justification for the Commission to approve the higher imputed long-term debt cost proposed by Great Oaks.

We find that a cost of 6.5 percent for both actual and imputed long-term debt is reasonable. We agree with Cal Advocates that a 7.5 percent cost of imputed long-term debt is excessive and distinctly higher than the rates of the other Applicants as well as Great Oaks' cost of actual long-term debt. While we recognize that the specific characteristics of Great Oaks may justify a higher cost of long-term debt, its proposed rate of 7.5 percent is not reasonable. A 6.5 percent cost for imputed long-term debt provides a reasonable rate and matches the rate for actual long-term debt that both Great Oaks and Cal Advocates support. Therefore, we authorize a cost of 6.5 percent for both imputed and actual long-term debt.

6.3. Suburban

Suburban requests that the Commission adopt a cost of long-term debt of 5.03 percent. Cal Advocates agrees with the cost of long-term debt requested by Suburban.[104] We find Suburban's unopposed request of a 5.03 percent cost for long-term debt reasonable and consistent with the record. Therefore, we authorize a cost of long-term debt of 5.03 percent for Suburban.

6.4. Liberty

Liberty requests that the Commission authorize a cost of long-term debt of 3.99 percent.[105] Cal Advocates agrees with the long-term debt requested by

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[103] *Ibid.*

[104] Cal Advocates Opening Brief at iv.

[105] Liberty Opening Brief at 2.

Liberty.[106] We find Liberty's unopposed request is reasonable and consistent with the record. Therefore, we authorize a cost of long-term debt of 3.99 percent for Liberty.

6.5. Summary of Adopted Cost of Long-Term Debt

The adopted costs of long-term debt are summarized below.

Table 9

Adopted Cost of Long-Term Debt

San Gabriel	4.99%
Great Oaks	6.50% (actual and imputed)
Suburban	5.03%
Liberty	3.99%

7. Preferred Stock

Suburban requests that the Commission authorize a cost of preferred stock of 4.24 percent.[107] Cal Advocates agrees with the preferred stock cost requested by Suburban.[108] We find Suburban's unopposed request is reasonable and consistent with the record. Therefore, we authorize a cost of preferred stock average of 4.24 percent for Suburban.

8. Water Cost of Capital Adjustment Mechanism

The WCCM is a mechanism that allows for automatic annual adjustments to the return on equity under specific circumstances. The Commission first approved a cost of capital adjustment mechanism for the three investor-owned large multi-district Class A water utilities in D.09-07-051. The Commission

[106] Cal Advocates Opening Brief at iv.

[107] Suburban Opening Brief at 41.

[108] Cal Advocates Opening Brief at iv.

found the WCCM was reasonable because it: (1) provides a synchronized means to adjust the return on equity to reflect significant changes in interest rates, (2) fairly balances intervenor and shareholder interests and (3) provides a reasonable adjustment to the return on equity.[109] A WCCM for the Applicants was originally approved in D.10-10-035 and then was extended by D.13-05-027 and D.18-12-002.[110]

San Gabriel, Great Oaks, Suburban and Liberty all request continuation of the WCCM, with effective dates of January 1, 2025 for San Gabriel and Suburban and July 1, 2025 for Great Oaks and Liberty.[111] Cal Advocates does not oppose continuation of the WCCM, but recommends an effective date of January 1, 2025, for all four utilities if the WCCM triggers.[112]

Cal Advocates argues that using different initial benchmark periods is "unreasonable as it allows the Applicants to measure the WCCM trigger timeline in different economic environments, which potentially could allow them to readjust their authorized [return on equity] at different times."[113] Great Oaks agrees to change its effective date to January 1, 2025, but Liberty maintains that an effective date of July 1, 2025 is appropriate because it is consistent with: (1) Liberty's effective date of the newly authorized cost of capital from this proceeding (July 1, 2024) and (2) previous cost of capital decisions.[114] Liberty further asserts that Cal Advocates' proposed January 1, 2025 date is "arbitrary,

[109] D.09-07-051 at 8 and Conclusion of Law 2.

[110] D.10-10-035 at 62; D.13-05-027 at 11; D.18-12-002 at Appendix A.

[111] San Grabriel Opening Brief at 40; Suburban Opening Brief at 45; Great Oaks Opening Brief at 41; Liberty Opening Brief at 21.

[112] Cal Advocates Opening Brief at 30.

[113] *Id*. at 31.

[114] Great Oaks Opening Brief at 41; Liberty Opening Brief at 21.

would create inconsistency between Liberty's [General Rate Case] and cost of capital effective dates[.]"[115]

Although Cal Advocates does not oppose continuation of the WCCM in this proceeding, it recommends that the Commission reevaluate the necessity of continuing the WCCM in the next cost of capital proceeding.[116] Cal Advocates indicates that the reevaluation is merited because: (1) the WCCM has not triggered for the small water utilities and (2) the capital markets have remained stable.[117]

The Applicants oppose Cal Advocates' request on procedural and substantive grounds. San Gabriel and Liberty argue that this request is outside of the scope of this proceeding and is problematic because it would prematurely decide the matter prior to the next cost of capital proceeding.[118] San Gabriel and Suburban also challenge the substantive premise of Cal Advocates' argument, asserting that continuation of the WCCM is reasonable because it: (1) mitigates the impact of significant changes in interest rates that could occur between cost of capital proceedings and (2) reduces regulatory lag by ensuring the authorized rate of return accurately reflects increases or decreases in the cost of capital as market conditions change.[119] They also note that the WCCM has triggered twice for the large Class A water utilities in 2023.[120]

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[115] Liberty Opening Brief at 21.

[116] Cal Advocates Opening Brief at 29.

[117] Exh. CalAdv-1 (Baki Direct) at 18.

[118] San Gabriel Opening Brief at 39; Liberty Opening Brief at 21.

[119] San Gabriel Opening Brief at 40; San Gabriel Reply Brief at 16.

[120] San Gabriel Opening Brief at 41; Suburban Opening Brief at 45; Great Oaks Opening Brief at 42.

We grant the unopposed request to continue the WCCM for San Gabriel, Great Oaks, Suburban and Liberty. It is reasonable to maintain the mechanism during that time to mitigate the impacts of potential significant changes in the capital markets. We adopt the unopposed requests of San Gabriel and Suburban for an effective date of January 1, 2025 if the WCCM triggers. While we recognize that having the same effective trigger date for all four Applicants holds appeal, we find that having effective triggers dates that are consistent between a utility's General Rate Case and cost of capital dates are preferable to mitigate customer confusion regarding potential rate increases and reduce the number of regulatory filings. Therefore, we adopt an effective date of July 1, 2025, for Great Oaks and Liberty if the WCCM triggers.

The adopted WCCM dates are reflected below.

Table 10

Adopted WCCM Dates

Applicant	Initial 12-month Benchmark Period	Initial 12-month Measurement Period	Effective Date if WCCM Triggers
San Gabriel	October 1, 2022, to September 30, 2023	October 1, 2023, to September 30, 2024	January 1, 2025
Great Oaks	May 1, 2023, to April 30, 2024	May 1, 2024, to April 30, 2025	July 1, 2025
Suburban	October 1, 2022, to September 30, 2023	October 1, 2023, to September 30, 2024	January 1, 2025
Liberty	May 1, 2023, to April 30, 2024	May 1, 2024, to April 30, 2025	July 1, 2025

We will grant the request for a reevaluation of the WCCM in the next cost of capital proceeding. Given the amount of time since its adoption and the attendant change in circumstances, we find a general evaluation of the WCCM is merited, including whether it should continue, or if adjustments are necessary. While we recognize the potential benefits of the WCCM, an evaluation of it in the next cost of capital proceeding is warranted to ensure that the interests of both ratepayers and the utilities are maximized to the extent possible.

9. Summary of Public Comment

Rule 1.18 allows any member of the public to submit written comment in any Commission proceeding using the "Public Comment" tab of the online Docket Card for that proceeding on the Commission's website. Multiple customers submitted written comments in the Docket Card regarding the applications of San Gabriel, Suburban and Liberty. The comments generally opposed any requested rate increases, citing concerns regarding affordability and lack of clarity as to requested relief.

10. Procedural Matters

All motions not ruled on are deemed denied.

11. Comments on Proposed Decision

The proposed decision of ALJ Marcelo Lins Poirier in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on __________, and reply comments were filed on _____________ by ________________.

12. Assignment of Proceeding

Darcie L. Houck is the assigned Commissioner and Marcelo Lins Poirier is the assigned ALJ in this proceeding.

Findings of Fact

1. The Applicants are public utilities subject to the jurisdiction of the Commission.

2. The Commission consolidated the applications pursuant to Rule 7.4.

3. The Applicants have complied with Rule 3.2.

4. The capital structures of the Applicants are comprised of common equity, long-term debt, and preferred stock.

5. No party opposed San Gabriel's proposed capital structure.

6. No party opposed Great Oaks' proposed capital structure.

7. Fixing a cost of capital for future periods is an exercise in economic and financial forecasting.

8. The Commission has consistently evaluated analytical financial models as a starting point to arrive at a range of fair and reasonable returns on equity.

9. The financial models used in the Commission's cost of capital proceedings are not determinative and are tempered with a great deal of judgment.

10. A Commission proceeding determining a return on equity commonly use several financial models, including the DCF, RPM, and CAPM.

11. The parties utilized variants of the financial models or additional models in this proceeding.

12. The DCF and CAPM financial models use a proxy group comprised of companies with characteristics and risks comparable to those of the Applicants.

13. The proxy groups of the Applicants and Cal Advocates include the same six water utilities, but some of the Applicants include additional water utilities.

14. The Applicants used the DCF, RPM and CAPM models to develop their requested returns on equity, ranging from a low of 9.7 percent for Great Oaks to a high of 11.0 percent for Suburban.

15. Cal Advocates used a version of the DCF and variations of the CAPM as its basis to propose returns on equity for the Applicants ranging from a low of 7.44 percent for San Gabriel, Great Oaks and Suburban to 7.62 percent for Liberty.

16. The financial models used in this proceeding are highly susceptible to subjective inputs and the inconsistency of these inputs has produced a highly variable range of results.

17. The Commission historically reviewed an array of models with varied assumptions before exercising its judgment in adopting a return on equity.

18. The results of the financial models cannot be relied upon exclusively to develop an exact cost of equity but are useful to establish a range of required returns to consider in selecting the authorized return on equity and to evaluate trends in investor expectations.

19. The adjustments to the models proposed by the Applicants and Cal Advocates and the criticisms thereof, as with the models themselves, are helpful in establishing a range of reasonable outcomes.

20. The WCCM allows for an accurate adjustment based on market interest rates between base year proceedings.

21. The continuation of the WCCM authorized by the Commission in D.09-07-051, D.12-07-009, D.13-05-027 and D.18-12-002 is uncontested.

22. No party opposes Suburban's requested cost of long-term debt or cost of preferred stock.

23. No party opposes Liberty's requested cost of long-term debt.

Conclusions of Law

1. After consideration, evaluation, and weighing of parties' evidence, we determine the capital structures, returns on equity, costs of long-term debt, and preferred stock adopted in this decision are consistent with all Constitutional and statutory requirements.

2. In establishing the individualized cost of capital for each applicant, we follow established standards for setting a fair rate of return, consider recent

Commission decisions covering the same subject, evaluate valuation information, and exercise our judgment based on the specific circumstances of a utility.

3. The forecast methodology produces a more reasonable result for establishing a capital structure because it includes adjustments for known and foreseeable events proceedings.

4. The methodology used by Suburban to establish its proposed capital structure is consistent with the Water Rate Case Plan.

5. The legal standard for setting the fair rate of return has been established by the United States Supreme Court in the *Bluefield*, *Hope*, and *Duquesne* cases.

6. A utility's overall return should be comparable to the overall return earned at the same time and in the same general part of the country on investments in other business undertakings attended by corresponding risks and uncertainties.

7. Authorized rates of returns will not be judged invalid as long as they enable a utility to maintain financial integrity, to attract capital, and to compensate investors for the risks they assume, and must not be so low as to be confiscatory.

8. The Commission need not use a particular methodology in applying the Constitutional standard, as long as the Commission allows the utility a reasonable opportunity to earn a fair return on investments.

9. The consolidation of these applications does not mean that a uniform return on equity should be applied to each of the Applicants.

10. A capital structure of 64.95 percent common stock equity and 33.05 percent long-term debt for San Gabriel is reasonable.

11. A capital structure of 70.0 percent common equity, 12.70 percent long-term debt, and 17.30 percent imputed long-term debt for Great Oaks is reasonable.

12. A capital structure of 62.0 percent common stock equity, 36.69 percent long-term debt and 1.31 percent preferred stock for Suburban is reasonable.

13. A capital structure of 57.0 percent common equity and 43.0 percent long-term debt for Liberty is reasonable.

14. The Commission should not make any adjustment to the financial modeling results for other financial, business or regulatory risks because the financial modeling results already adequately reflect those risks.

15. A return on equity range of 8.22 percent and percent 11.52 percent is fair and reasonable.

16. A 9.34 percent return on equity for San Gabriel is fair and reasonable.

17. An 8.78 percent return on equity for Great Oaks is fair and reasonable.

18. A 9.46 percent return on equity for Suburban is fair and reasonable.

19. A 9.57 percent return on equity for Liberty is fair and reasonable.

20. The methodology used by San Gabriel to calculate a proposed cost of long-term debt is consistent with Commission precedent.

21. A 4.99 percent cost of long-term debt for San Gabriel is reasonable.

22. A 6.50 percent cost of long-term debt for Great Oaks' actual and imputed debt is reasonable.

23. A 5.03 percent cost of long-term debt for Suburban is reasonable.

24. A 4.24 percent cost of preferred stock for Suburban is reasonable.

25. A 3.99 percent cost of long-term debt for Liberty is reasonable.

26. A 7.82 percent return on rate base for the calendar years 2024, 2025, and 2026 for San Gabriel is reasonable. An 8.10 percent return on rate base for the calendar years 2024, 2025, and 2026 for Great Oaks is reasonable.

27. A 7.77 percent return on rate base for the calendar years 2024, 2025, and 2026 for Suburban is reasonable.

28. A 7.17 percent return on rate base for the calendar years 2024, 2025, and 2026 for Liberty is reasonable.

29. The Commission should authorize the continuation of the WCCM consistent with D.09-07-051 and D.12-07-009.

30. If the WCCM triggers, the Commission should adopt an effective date of January 1, 2025 for San Gabriel and Suburban and July 1, 2025 for Great Oaks and Liberty.

31. The Commission should conduct a general evaluation of the WCCM in the next cost of capital proceeding.

32. All pending motions in this proceeding not specifically addressed in this decision, or not previously addressed, should be denied as moot.

33. Applications 23-05-001, 23-05-002, 23-05-003 and 23-05-004 should be closed.

O R D E R

IT IS ORDERED that:

1. San Gabriel Valley Water Company is authorized a 9.34 percent return on equity and a 4.99 percent cost of long-term debt with a capital structure of 35.05 percent long-term debt and 64.95 percent common equity, resulting in a 7.82 percent return on rate base for the calendar years 2024, 2025, and 2026.

2. Great Oaks Water Company is authorized an 8.78 percent return on equity and a 6.50 percent cost of long-term debt with a capital structure of 12.70 percent actual long-term debt, 17.30 percent imputed long-term debt and 70.00 percent common equity, resulting in an 8.10 percent return on rate base for the calendar years 2024, 2025, and 2026.

3. Suburban Water Systems is authorized a 9.46 percent return on equity, a 5.03 percent cost of long-term debt and a preferred stock average cost of

4.24 percent with a capital structure of 36.69 percent long-term debt, 1.31 percent preferred stock and 62.00 percent common equity, resulting in a 7.77 percent return on rate base for the calendar years 2024, 2025, and 2026.

4. Liberty Utilities Corp. is authorized a 9.57 percent return on equity and a 3.99 percent cost of long-term debt with a capital structure of 43.00 percent long-term debt and 57.00 percent common equity, resulting in a 7.17 percent return on rate base for the calendar years 2024, 2025, and 2026.

5. San Gabriel Valley Water Company, Great Oaks Water Company, Suburban Water Services and Liberty Utilities Corp. shall each file a Tier 1 Advice Letter to implement rate changes to reflect the change in the cost of capital adopted herein.

6. All advice letters required in Ordering Paragraph 5 shall be filed within 30 days of the date of this order and the rate changes reflecting the approved cost of capitals shall be effective on the date of the filing subject to the determination by Water Division that the advice letters comply with this decision.

7. San Gabriel Valley Water Company, Great Oaks Water Company, Suburban Water Services and Liberty Utilities Corp. shall continue with their Water Cost of Capital Mechanism (WCCM) for 2025 and 2026, using the base year 2024 adopted in this decision. The effective dates if the WCCM triggers are January 1, 2025 for San Gabriel Valley Water Company and Suburban Water Services, and July 1, 2025 for Great Oaks Water Company and Liberty Utilities Corp.

8. All outstanding motions filed in this proceeding that have not yet been ruled on, are denied.

9. Applications (A.) 23-05-001, A.23-05-002, A.23-05-003 and A.23-05-004 are closed.

This order is effective today.

Dated _________________, at Sacramento, California