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Water Acquisitions

Staff Proposal

WATER DIVISION

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Executive Summary

The California Public Utilities Commission’s (Commission) Water Division recommends, in this staff proposal, refinements to the existing water utility acquisitions framework for consideration by the Commission. This proposal, which emerged from a comprehensive review through the rulemaking R.22-04-003, aims to align the Commission’s goals with the Safe Drinking Water Act of 2021 and the State Water Resources Control Board’s (SWRCB) Safe and Affordable Funding for Equity and Resilience (SAFER) Program. The revised framework addresses issues within the current acquisitions process while focusing on failing, at-risk, and potentially at-risk (failing or at-risk) systems.¹ It seeks to provide clearer guidelines for valuations of water systems; review of ratepayer impacts; and reporting and scheduling requirements. Additionally, the revised framework aims to enhance coordination with the SWRCB and resolve ambiguities related to acquisitions involving municipal or mutual water systems.

As part of the revised framework, Water Division recommends prioritization of acquisitions involving water systems identified by the SWRCB as failing or at-risk. This priority is consistent with the mandates outlined in Public Utilities (Pub. Util.) Code Section 2721(d), which requires the Commission to expedite the review of acquisitions that address the most critical water systems in need. The proposed revisions would redefine the criteria for identifying water systems that are considered failing or at-risk, to ensure those systems receive focused attention from potential acquirers, particularly Investor-Owned Water Utilities (Water IOUs) that have the capacity to manage and improve these systems. Incentives for Water IOUs to acquire failing or at-risk water systems would be recalibrated from the existing framework by narrowing the eligibility for authorizations of memorandum accounts, and the revised framework would allow for an expedited review process that prioritizes such acquisitions.

Water Division recommends a streamlined acquisition process. The streamlined process consists of several key proposals, including the introduction of a mandatory Prefiling Conference, where Water IOUs will engage with the Commission’s Water Division to discuss proposed acquisitions, document infrastructure needs, and review potential funding sources. This early-stage consultation is designed to expedite the subsequent application or advice letter process by minimizing delays and ensuring that necessary improvements to failing systems can begin promptly.

The revised framework set out in the Water Division proposal would update the valuation methods and rate-setting processes to ensure a more accurate reflection of the true costs and benefits associated with acquiring water systems. Rather than relying strictly on purchase prices as the basis for determining the rate base, the Commission would apply its discretion under Pub. Util. Code Section 2720 to assess how much of the fair market value should be included in rate base as part of an acquisition. The revised framework would require the acquiring utility to present multiple assessments of value to provide a clearer assessment of acquisition premiums. This approach allows for a more nuanced and equitable incorporation of acquisition costs into the rate base, ensuring that only reasonable and justifiable premiums are passed on to ratepayers.

¹ Such systems are identified by the SWRCB based on criteria to meet California’s Human Right to Water (HR2W), Water Code Section 106.3.

The ratepayer impact analysis is another vital aspect of the revised framework, where the Commission would require Water IOUs to present detailed forecasts of how acquisitions will affect customer rates. The acquiring utility would provide separate rate impact analyses for both existing and acquired customers, and notices to customers would be consistent. The Commission's review standards for acquisitions should be improved by requiring the acquiring utility to quantify the ratepayer benefits from the proposed acquisition. This transparency ensures that both existing and new customers are fully informed of the financial implications of any acquisition, allowing for more informed decision-making by the Commission and all stakeholders involved.

As the revised framework proposes establishing requirements for analyzing acquisition premiums and ratepayer impacts, the Commission should also consider applying its existing gain on sale rules for proposed water system acquisitions. Allowing ratepayers to receive a percentage of the purchase price would help reduce the rate impact of the proposed acquisition.

The revised framework clarifies reporting requirements for proposed acquisitions and allows for utility enforcement to meet compliance. The revised framework standardizes scheduling of proposed acquisitions and takes into account different types of acquisitions depending on the filing, purchase price, and whether the system is failing or at-risk.

Furthermore, the revised framework proposes enhanced coordination between the Commission and the SWRCB, particularly in the areas of data sharing, grant funding, and the monitoring of acquisition impacts. The establishment of a Joint Task Force, the development of shared documents, and data sharing protocols between the two agencies are expected to significantly improve the acquisition process, ensuring that all relevant information is available to support the timely and effective resolution of water system acquisitions.

In conclusion, the proposed revisions to the acquisition framework represent a significant step forward in addressing the challenges posed when an IOU acquires a water system, especially those that are failing or at-risk. By prioritizing these cases, refining the acquisition process, and enhancing inter-agency coordination, the Commission would ensure that the state's water systems are managed sustainably, with the highest standards of public health and safety at the forefront. Water Division believes these changes are not only necessary for the continued provision of safe drinking water but also for the long-term resilience and sustainability of California's water infrastructure.

Acquisitions Involving Failing and At-Risk Water Systems

Definition of Failing or At-Risk Water Systems

The Settlement Agreement adopted in Decision (D.) 99-10-064 (Existing Framework) defined an Inadequately Operated and Maintained (IOM) Small Water Utility as “any operation serving under 2,000 customers that is subject to an outstanding order of the Department of Health Services to implement improvement.”² This definition as well as the term “IOM” should no longer be used by the Commission as this term is now outdated. For consistency, the Commission should align itself with the Safe Drinking Water Act of 2021 (2021 Act) and the existing SWRCB’s SAFER Program through its annual Needs Assessment.

The 2021 Act added Sections 2721 and 2722 to the Pub. Util. Code and focuses on acquisitions involving “small community water systems” and “state small water systems” that have been identified by the SWRCB as failing or at-risk. A small community water system is defined as serving no more than 3,300 connections or 10,000 people.³ A state small water system is defined as serving between 5 to 14 connections and no more than 25 people.⁴ The SWRCB’s Needs Assessment includes water systems up to 30,000 connections or 100,000 people.⁵ The SWRCB defines a failing system as a water system that is out of compliance or consistently fails to meet primary drinking water standards.⁶ The SWRCB identifies at-risk and potentially at-risk systems based on the results of the Needs Assessment.

The Commission should use the same identification system as those implemented by the SWRCB to prioritize water systems for acquisitions in the revised framework:

- Failing
- At-Risk
- Potentially At-Risk

Pursuant to Pub. Util. Code Section 2721(d), the Commission should further prioritize acquisitions involving small community or state small water systems that are identified as failing, at-risk, or potentially at-risk (failing or at-risk).

² D.99-10-064 Appendix D Section 3.01.

³ Health and Safety Code Section 116275(z).

⁴ Health and Safety Code Section 116275(n).

⁵ SWRCB’s 2023 Drinking Water Needs Assessment pg. 6.

⁶ SWRCB’s Failing Water Systems: The Human Right to Water (HR2W) List Criteria (April 2021) pg. 3.

Acquisition Process Involving Failing or At-Risk Water Systems

Water IOUs seeking to acquire failing or at-risk water systems should be granted an expedited Commission review process. Under Pub. Util. Code 851 and 2721(c), Water IOUs may file an advice letter for acquisitions valued at \$5 million or less. The advice letter process for acquisitions generally takes less time at the Commission than the application process. The revised framework should encourage Water IOUs to file an advice letter to acquire water systems identified as failing or at-risk if those systems are valued under \$5 million. For Water IOUs that file an application to acquire a failing or at-risk water system, the Commission should prioritize such proceedings before other acquisitions involving systems that are not identified as failing or at-risk.

The proposed expedited review process should serve as an incentive for Water IOUs to seek acquisitions of failing or at-risk water systems. Currently, the Existing Framework provides four incentives for these types of acquisitions:⁷

- A. Establish a memorandum account for expenses associated with unanticipated repairs
- B. Design rates to recover up to 100% of fixed costs in the service charge
- C. File for an increase in rates based on the Consumer Price Index
- D. Set rates based on the rate of return for a Class C or D utility

Of the four incentives, the Water Division proposal only applies the memorandum account incentive to the revised framework in order to allow recovery by the Water IOUs for substantial expenses incurred after the acquisition process is finalized. The other three incentives would not be included with the revised framework as only the memorandum account incentive has been consistently applied by the Commission⁸. Acquisitions involving non-failing systems would not be allowed this memorandum account incentive to emphasize the greater need to acquire failing or at-risk systems. Table 1 summarizes the proposed incentives for the revised framework.

⁷ Section 3.03 of the Settlement Agreement in D.99-10-064.

⁸ Since 2007, the memo account incentive has been requested and approved 8 times: D.07-11-034, D.15-11-012, D.16-11-014, D.16-12-014, D.19-04-015, D.19-11-003, D.19-12-038, and D.21-08-002.

**Table 1: Revised Framework Proposed Incentives
Only for Acquisitions of Failing/At-Risk System**

Incentive	Benefits
Memorandum Account	<ul style="list-style-type: none"> Establish a memorandum account for expenses associated with unanticipated repairs Allows recovery of substantial expenses discovered after the acquisition
Shorter Review Period	<ul style="list-style-type: none"> 12 months for Commission to review an acquisition application (compared to 18 months normal review) 180 days for Commission to review an acquisition advice letter (compared to 12 months normal review) 100 days for Commission to review an unprotested acquisition advice letter for an acquisition under \$5 million (compared to 120 days normal review)
Prioritized Proceeding	<ul style="list-style-type: none"> Commission review priority over other acquisitions not involving failing or at-risk systems
Flexibility in Applying Review Standards	<ul style="list-style-type: none"> Not required to apply both the Ratepayer Indifference Test and the Quantifiable Ratepayer Benefit standards
Flexibility in Applying Public Noticing Rules	<ul style="list-style-type: none"> Lowest cost option for noticing

Prefiling Conference

This proposal requires that a Prefiling Conference be held before an application or advice letter is filed to expedite the review of all acquisitions presented before the Commission, especially for those involving failing or at-risk water systems.⁹ The Prefiling Conference requirement would be applied to all proposed acquisitions and could be held virtually or in-person at any Commission office. At the Prefiling Conference, the applicant or Water IOU proposing the acquisition will meet with Water Division to discuss the proposed acquisition and provide proper documentation as required in Section 10.2 of D.20-08-047. The full list is provided in Appendix A. These documents include, but are not limited to, the following:

- Purchase Agreement
- Proposed/potential infrastructure upgrades
- Grant Funding application/status
- Forecasted rates

⁹ Section 2.02 of the Existing Framework required a Notice of Intention to be filed 40 days before the proposed acquisition.

At least 60 days before the water IOU plans to submit a proposed acquisition filing, it must participate in a Prefiling Conference.¹⁰ Figure 2 in the Scheduling Section displays the flowchart for the acquisition process including the Prefiling Conference.

Memorandum Accounts

As discussed above, the revised framework would continue allowing Water IOUs to establish a memorandum account only if the acquisition involves a failing or at-risk water system. To increase transparency in the acquisition process, the language from the requested memorandum account must explicitly state what costs are allowed to be tracked and the exact conditions that must be satisfied for cost recovery. Memorandum accounts would not be allowed for acquisitions involving water systems that are neither failing nor at-risk. For acquisitions of water systems that are neither failing nor at-risk, the acquiring utility would forecast acquisition costs in General Rate Case (GRC) applications and bear the risk of that forecast until new rates are established through the GRC process.

¹⁰ This requirement is similar to the GRC schedule for Class A IOUs adopted in the Revised Rate Case Plan where the IOUs are required to file a proposed application 60 days before the final application, See D.07-05-062 and D.07-05-062 Appendix A, pg. A-5

Price and Valuation

Commission's Valuation Authority

Public Utilities Code Section 2720(a) (Section 2720(a)) sets the standard of the fair market value for establishing rate base when a Commission-regulated water utility acquires a water system:

(a) The commission shall use the standard of fair market value when establishing the rate base value for the distribution system of a public water system acquired by a water corporation. This standard shall be used for ratesetting.

(1) For purposes of this section, “public water system” shall have the same meaning as set forth in Section 116275 of the Health and Safety Code.

(2) For purposes of this section, “fair market value” shall have the same meaning as set forth in Section 1263.320 of the Code of Civil Procedure.

Section 2720(a)(2) refers to the Code of Civil Procedure (CCP) 1263.320 for determination of fair market value. CCP Section 1263.320, in turn, provides:

(a) The fair market value of the property taken is the highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy but under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.

(b) The fair market value of property taken for which there is no relevant, comparable market is its value on the date of valuation as determined by any method of valuation that is just and equitable.

As supported in the comments filed by the utilities in the rulemaking, the fair market value is well defined in CCP 1263.320(a) and applies to proposed acquisitions between two utilities that come to an agreement on a purchase price. If there is an agreed purchase price, CCP 1263.320(b) would not be applied to determine the fair market value.

This has led to the perception that under Pub. Util. Code Section 2720(a) the entire purchase price must be placed into rate base; however, Pub. Util. Code Section 2720(b) allows the Commission significant discretion:

(b) If the fair market value exceeds reproduction cost, as determined in accordance with Section 820 of the Evidence Code, the commission may include the difference in the rate base for ratesetting purposes if it finds that the additional amounts are fair and reasonable. In determining whether the additional amounts are fair and reasonable the commission shall consider whether the acquisition of the public water system will improve water system reliability, whether the ability of the water system to comply with health and safety regulations is improved, whether the water corporation by acquiring the public water system can achieve efficiencies and economies of scale that would not otherwise be available, and

whether the effect on existing customers of the water corporation and the acquired public water system is fair and reasonable.

Section 2720(b) allows the Commission to apply protections when the purchase price exceeds the cost to replace the system, also known as reproduction cost or RCNLD (replacement cost new less depreciation).¹¹ In that case, the Commission has discretion to permit all or part of the difference, also known as the acquisition premium, into the acquiring utility's rate base.

Section 2720(b) lays out the factors for the Commission to consider when determining how much of the acquisition premium can be placed into rate base:

- whether the acquisition of the water system will improve water system reliability;
- whether the ability of the water system to comply with health and safety regulations is improved;
- whether the acquiring utility can achieve efficiencies and economies of scale that would not otherwise be available; and
- whether the effect on existing customers of the acquiring utility and the acquired water system is fair and reasonable.

Thus, using the entire purchase price to establish rate base is not a guarantee. The acquiring utility bears the burden of proof for placing the acquisition premium into rate base. The revised framework acknowledges that the Commission has authority to permit all or part of the acquisition premium into the acquiring utility's rate base pursuant to Section 2720(b). This allows the Commission to protect customers from the possibility of a willing utility buyer and utility seller agreeing on an inflated purchase price, preventing overpayment and an increased amount being placed into rate base. As California Water Association (CWA) stated in the opening comments to Workshop #2, "this provides an incentive for the purchasing water utility to negotiate for a lower purchase price, since there is a risk that the Commission may not approve a transaction involving recovery of an acquisition premium." The Commission would use its discretion in its review of a proposed acquisition to reasonably limit the incentive for an acquiring utility to seek an unjustifiable high price for the system that it is buying. To offer an incentive for utilities to acquire failing or at-risk water systems, the Commission could exercise its discretion by placing more of the acquisition premium into rate base for these systems.

¹¹ As defined by Evidence Code 820 which states:

When relevant to the determination of the value of property, a witness may take into account as a basis for his opinion the value of the property or property interest being valued as indicated by the value of the land together with the cost of replacing or reproducing the existing improvements thereon, if the improvements enhance the value of the property or property interest for its highest and best use, less whatever depreciation or obsolescence the improvements have suffered.

Valuation Methods

When determining the value of a water system in a proposed acquisition, there are multiple valuation methods that may be applied. Cal Advocates in their Workshop #2 presentation and opening comments to Workshop #2 defined four methods for consideration in the Commission’s decision-making process in addition to the statutorily defined Fair Market Value:¹²

- 1) **Reproduction Cost New Less Depreciation (RCNLD)**: the current cost to replace the system minus actual depreciation and other liabilities
- 2) **Book Value**: the original cost minus book depreciation
- 3) **Comparable Value**: compare to similar approved acquisitions with appropriate adjustments
- 4) **Income Value**: estimated present-day value of future incomes from the system

As discussed in the prior section, the fair market value is defined in CCP Section 1263.320(a) as the purchase price under certain conditions. Purchase price and RCNLD are essential to determining if there is an acquisition premium for the Commission to review in accordance with Section 2720(b). In a proposed acquisition, the revised framework should require the acquiring utility to provide valuations of both the fair market value and the RCNLD.

Book value is an accounting concept that is not typically accepted as the basis for just compensation¹³ because it does not take into account the time-value of money, appreciation, functional obsolescence, or physical deterioration. However, book value can be used in determining gain on sale, as discussed later.

In the valuations conducted for a proposed acquisition, the acquiring utility would identify and quantify existing, pending, and potential liabilities of the acquired system. This will introduce more transparency of potentially deferred capital costs of an acquired system into the valuation process and will require the acquiring utility to explain how the valuation process accounts for these potential impacts to the overall cost of acquiring a water system.

If the Commission were to consider CCP 1263.320(b) and the valuation methods are not restricted to the purchase price, the revised framework gives the acquiring utility the option to choose comparable value or income value for valuation of the acquired water system. If review of the proposed acquisition is considered in a formal proceeding, another party would be allowed to select, out of the four valuation methods, a different method or combination of methods from the acquiring utility to develop a second valuation. If the proposed acquisition is under review as an advice letter, Water Division would be granted the authority to direct the acquiring utility to perform a second valuation. Having more than one valuation study of a water system provides the Commission with more options for consideration and data points to review and determine the final value.

¹² Cal Advocates’ Workshop 2 presentation, slide 124.

¹³ Willamette Management Associates’ Workshop 2 presentation, slide 29.

Third-Party Appraisals

The Commission could consider recommending to the CA legislature an appraisal process to be adopted similar to the Pennsylvania Public Utility Commission’s (PA PUC) process. The PA PUC instituted a rigorous yet streamlined system for evaluating water system acquisitions.¹⁴ The process is detailed as follows:

- a. Selection of Utility Valuation Experts (UVEs): PA PUC maintains a list of registered UVEs that consists of professionals with proven expertise in assessing the value of utility systems.¹⁵ When an acquisition is proposed, the acquiring utility must select a registered UVE from the PA PUC’s list to conduct a separate independent valuation.
- b. Submission and Review of Appraisal: The PA PUC provides guidelines and templates for the acquiring utility to meet application requirements, standard data requests, UVE requirements, and UVE direct testimony. The appraisal reports are incorporated into the application and should detail the valuation methodology, data sources, and final valuation figure.
- c. Stakeholder Feedback: Once submitted, the appraisal is made available for stakeholder comments. This allows interested parties to voice any concerns or disagreements with the valuation, ensuring transparency and engagement.
- d. Final Decision: The PA PUC reviews the submitted appraisal, considers stakeholder feedback, and makes a final determination on the valuation of the water system. This decision can accept, reject, or adjust the valuation based on the evidence provided. The review timeline for the PA PUC is six months.

While the third-party appraisal process for the Commission may be considered for modification by the California legislature, the acquisitions of failing or at-risk water systems should be incentivized by making third-party appraisals optional with the revised framework for these types of acquisitions. As evidenced in comments provided by parties, acquisitions of failing or at-risk systems may result in a purchase price with no material impact to ratepayers or no addition to rate base¹⁶ due to the nature of the transaction involving a failing or at-risk system with significant liabilities. To augment the third-party appraisal process for these types of systems, these acquisitions should reference existing public documents for the respective water system including the following: Annual Reports provided to the Commission; Electronic Annual Report provided to the SWRCB; outstanding compliance reports provided to the SWRCB’s Division of Drinking Water; or any other reports describing the current status of the acquired system.

Valuation Trend Analysis

In addition to valuation studies and appraisals, the Commission adopted in Section 10.2 of D.20-08-047 a list of requirements for the acquiring utility to submit with the acquisition application.¹⁷ The revised

¹⁴ Pennsylvania Consolidated Statute Title 66, Section 1329 (66 Pa. C. S. § 1329 or Section 1329)

¹⁵ Prospective UVEs are invited by the PA PUC to apply to the PA PUC’s official list of UVEs.

¹⁶ Acquisition examples: D.07-05-053 Grand Oaks Water Company, Resolution (Res.) W-5206 Crane Ridge Mutual Water Company, Res. W-5237 Robbins Water System, California Water Service Advice Letter 2444 Skylonda Mutual Water Company, San Jose Water Company Advice Letter 600 Sierra Road Improvement Association.

¹⁷ The list of requirements should now be provided during the prefiling conference with Water Division.

framework proposes to expand on the previously adopted list by requiring the acquiring utility to submit a report that examines the changing trends of the value of water systems. The Commission currently does not have access to sufficient data to properly study these trends. The more data that utilities can provide, the better equipped the Commission will be in properly evaluating a water system acquisition.

With the understanding that a variety of factors may impact the overall purchase price in an acquisition, the report submitted by the acquiring utility should include an analysis of purchase price-per-connection. This analysis should include a comparison of the proposed acquisition with previously approved acquisitions. The Commission’s Water Division may work with the utilities to consider establishing parameters or benchmarks for consistency in this analysis. The Commission would periodically review and update its analysis and parameters.

Gain on Sale

As the revised framework looks to improve the pricing and valuation review process in water system acquisitions, the Commission could consider expanding D.06-05-041 and apply the gain on sale rules to acquisitions involving water systems. Gain on sale is the purchase price of an asset minus “the acquisition cost of the non-depreciable asset or the depreciated book value of the depreciable asset.”¹⁸ This is similar to the definition of an acquisition premium with two significant differences:

1. The acquisition premium is based upon purchase price minus the RCNLD value and the gain on sale is the purchase price minus the book value (which could be lower or higher than the present RCNLD value).
2. Gain on sale rules apply to the seller’s (acquired utility’s) profits, whereas acquisition premium affects how much of the purchase price goes into the buyer’s (acquiring utility’s) rate base.

The “percentage allocation rule” associated with gain on sale was developed in D.06-05-041¹⁹, modified by D.06-12-043, where ratepayers receive 100% of gains on sale of depreciable assets. For non-depreciable assets, 67% of the gain on sale of non-depreciable assets are returned to ratepayers and 33% are returned to the shareholders. If the Commission were to apply the current gain on sale rules to water system acquisitions, ratepayers could receive portions of the profit earned from the sale of the acquired utility through an allocation account as described by Cal Advocates in the opening comments of Workshop #3.²⁰

Using a hypothetical acquisition to provide a numerical example for the proposal to apply the current gain on sale rules to water acquisitions, if Utility A agrees to purchase Utility B for \$1 million, the purchase price of the acquisition is \$1 million. The Commission reviews the acquisition and determines the RCNLD value of Utility B to be \$800k, which means the acquisition premium is \$200k. The Commission also determines the book value of Utility B to be \$500k, which means the gain on sale earned by Utility B is \$500k. The \$800k from the RCNLD valuation will be added to Utility A’s rate base and the \$200k acquisition premium

¹⁸ D.06-05-041 Findings of Fact 4

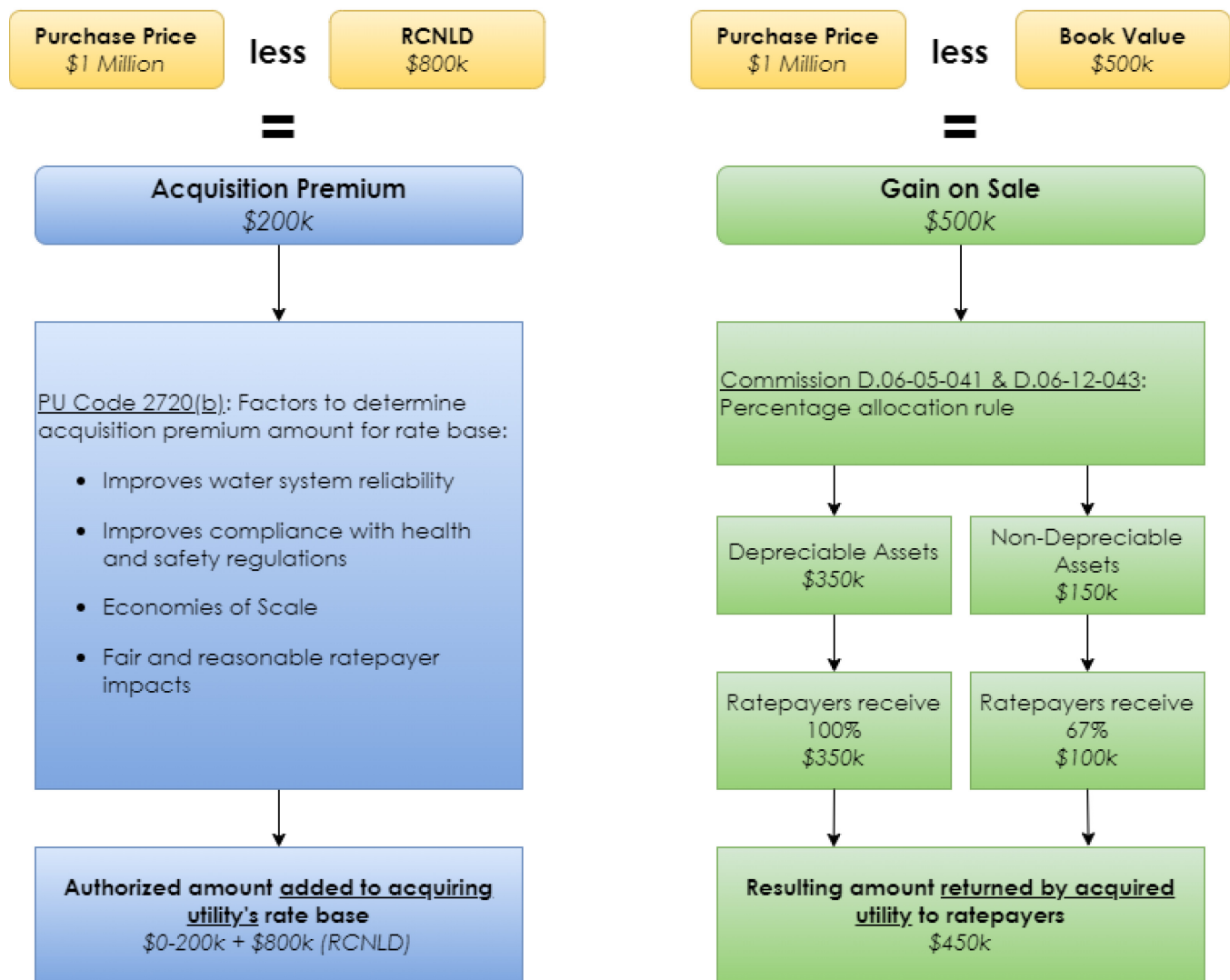
¹⁹ D.06-05-041 OP 1

²⁰ Cal Advocates’ Opening Comments on Workshop 3, pg. 13

is reviewed under Section 2720(b). The final authorized amount in Utility A's rate base can range from \$800k to \$1 million.

To apply the gain on sale principle to water acquisitions, the gain on sale rules from D.06-05-041 and D.06-12-043 are applied to the \$500k. The Commission determines from the \$500k that the depreciable assets are valued at \$350k and the non-depreciable assets at \$150k. Applying the percentage allocation rule, the Commission would authorize the entire \$350k of the depreciable assets be returned to ratepayers while for the non-depreciable assets, two thirds of the \$150k. The resulting amount that Utility B would return to ratepayers is \$450k. A flowchart illustrating the example calculation of the acquisition premium and gain on sale is shown in Figure 1.

Figure 1: Treatment of Purchase Price



As seen from the above example, applying the current gain on sale rules to water acquisitions would only affect the acquired utility and not the acquiring utility. Under the current rules and pursuant to Section 2720(b), the acquiring utility could potentially include in its rate base the entire purchase price. In the above example, the acquired utility (Utility B) would only net \$550k of the \$1 million purchase price since \$450k is returned to ratepayers. Whereas for the acquiring utility (Utility A), a minimum of \$800k is guaranteed in the acquiring utility's rate base with a possibility of it increasing to the full \$1 million. Thus, while ratepayers would benefit from the application of the current gain on sale rules to water system acquisitions, it does little to incentivize the acquiring utility to negotiate towards a lower purchase price. Hence, Water Division recommends that the Commission modify the current gain on sale rules to apply to the acquiring utility as well in water system acquisitions.

Furthermore, if the gain on sale rules are applied for water system acquisitions, flexibility should be given to the Commission when a proposed acquisition involves a failing or at-risk water system. To offer an incentive for utilities to acquire failing or at-risk water systems, the Commission could exercise its discretion in not applying the gain on sale rules, or partially applying gain on sale rules, for these types of acquisitions.

Water Rights

In prior acquisition proceedings and transactions, water rights were transferred along with other water system assets as part of an acquisition and were not valued separately in the proposed transaction. This process for treating water rights faces growing challenges with the increase in competition among water purveyors as water rights began to be valued as an individual asset in a proposed acquisition. There is no consistent treatment of water rights for water system acquisitions in the Existing Framework. As a result, the review of water rights was considered on a case-by-case basis in prior Commission Decisions.²¹ The revised framework proposes to allow for water rights to be treated as non-depreciable assets included into rate base as part of the Commission's review of the overall value of the acquired system. The acquiring utility would be required to provide a ratepayer cost/benefit analysis of adding the price paid for water rights into rate base. As with the acquisition premium, the Commission would have discretion on the amount placed into rate base of water rights paid by the acquiring utility.

²¹ Res. W-5080 and D.21-08-002 approved water rights as an individual asset and D.19-04-015 did not approve water rights as an individual asset.

Ratepayer Impacts

Ratepayer Impact Analysis

The Existing Framework currently has no requirement for the acquiring utility to include a rate impact analysis on their existing customers. Furthermore, in the past, there was no requirement to provide a rate impact analysis on either customer base of the acquiring or acquired utility if the acquiring utility proposes to implement the new rates as a result of the acquisition in a future GRC. The Commission changed this in 2020 with the adoption of D.20-08-047, which in Section 10.2 listed reporting requirements with a focus on rate impact analysis.

To improve the Commission’s review of acquisitions and provide more transparency to the ratepayers affected on both sides of an acquisition, the revised framework proposes incorporating the reporting requirements from D.20-08-047 and requiring the acquiring utilities to provide a rate impact analysis in their acquisition application or advice letter filing for both new and existing customers. The forecasted rates developed in an acquisition proceeding would be similar to the forecasted rates developed in a GRC where the acquiring utility forecasts at the time of filing the revenue increase; compares the proposed rates with present rates; and estimates the monthly bill impact for the average residential customer. As required by D.20-08-047, the acquiring utility must provide an estimate of the annual revenue requirement as a result of the acquisition and provide the assumptions for the annual revenue requirement, including expected rate of return, rate base, and expenses.

Since an acquisition involves two utilities, the acquiring utility would need to create two separate analysis of rate impacts: one for the existing customers and the other for the customers of the utility to be acquired. Table 2 shows a proposed template summarizing the ratepayer impact analysis. Any utility with a proposed acquisition would provide workpapers to Water Division that analyze the rate impacts using the current effective rates and water usages of both utilities at the time of filing the application or advice letter. The acquiring utility would be required to calculate the average residential monthly bills for customers of both utilities as if the rates were going to be in effect at the time of filing. For acquisitions over \$5 million, the acquiring utility would provide an additional analysis that shows forecasted rates if rates were phased in over a 3 year period. The acquiring utility would still be required to provide this ratepayer analysis even if the acquiring utility proposes to defer the rate increases to the next GRC or a later period.

Table 2: Ratepayer Impact Analysis²²

Existing [name of acquiring utility] Residential Customers						
Hypothetical Effective Date	Meter Size: 5/8"	Usage*	Pre-Acquisition Monthly Bill	Post-Acquisition Monthly Bill	\$ Increase	% Increase
Oct 17, 2024	Average	92.01 CGL	\$129.53	\$129.53	\$0.00	0%
	Tier 1	59.8 CGL	\$69.97	\$69.97	\$0.00	0%

Acquired Residential Customers of [name of acquired utility]						
Hypothetical Effective Date	Meter Size: 5/8"	Usage*	Pre-Acquisition Monthly Bill	Post-Acquisition Monthly Bill	\$ Increase	% Increase
Oct 17, 2024	Average	136.65 CGL	\$125.00	\$212.61	\$87.61	70.1%
	Tier 1	59.8 CGL	\$125.00	\$69.97	-\$55.03	-44.0%

Usage in CGL = 100 gallons

Supplementing the rate impact analysis, the workpapers would also include recently approved rate increases and/or surcharges from both the acquiring and acquired utility. For water IOUs, this would include the most recently authorized GRCs and applications and advice letters approved or filed within the prior year. Both utilities involved in the proposed acquisition would need to provide workpapers to Water Division that explain the rate increases and provide the monthly bill impacts as a result. For Class A IOUs that are required to submit a rate tracker in accordance with D.22-08-023 of the Affordability Proceeding R.18-07-006, the rate tracker may be used to fulfill this requirement. If the acquiring utility has a recent history of approved acquisitions, the same data must be provided in a current acquisition proposal. Comprehensive rate impact data will aid the Commission in its review of a proposed acquisition and display the full effect on ratepayers.

Public Noticing

Section 4.03 of the Existing Framework provides the following noticing requirements for proposed acquisitions:

Notice of a proposed acquisition should be given to all affected customers at the time when any advice letter or application is filed with the Commission. Additionally, the notice should contain a comparison of the rates before the acquisition and for the first year after the acquisition and identify any cost, including a reasonable return, not fully reflected in the first year's rates. With respect to the acquisition

²² Sample Figures taken from Res. W-5279: Acquisition of Corral De Tierra Water Company by California-American Water Company

of a water system of a municipality, similar notice should be given to all affected customers prior to any election.

However, these requirements only apply to proposed acquisitions of mutual or municipally-owned water systems. The Existing Framework does not include specific language requiring public noticing of proposed acquisitions when the acquired system is a water IOU. The revised framework would require public notices for any proposed acquisition filed with the Commission.

Public notice of a proposed acquisition similar to the GRC process should be applied to customers of acquiring and acquired utilities. For GRC applications, utilities are required to provide public notice under Rule 3.2(d) of the Commission’s Rules of Practice and Procedure:

(d) Electric, gas, heat, telephone, water, or sewer system corporations, within 45 days, if the corporation operates on a 30-day billing cycle, or within 75 days, if the corporation operates on a 60-day or longer billing cycle, after the filing of an application to increase any rate of charge, other than a change reflecting and passing through to customers only new costs to the corporation which do not result in changes in revenue allocation, for the services or commodities furnished by it, shall furnish to its customers affected by the proposed increase notice of its application either by electronically linking to such notice for customers that receive their bills electronically or, for customers that receive their bills by mail, by mailing such notice postage prepaid or including such notice with the regular bill. The notice shall state the amount of the proposed rate change expressed in both dollar and percentage terms for the entire rate change as well as for each customer classification, a brief statement of the reasons the change is required or sought, and the mailing, and if available, the e-mail, address of the Commission to which any customer inquiries may be directed regarding how to participate in, or receive further notices regarding the date, time, and place of any hearing on the application, and the mailing address of the corporation to which any customer inquiries may be directed.

The revised framework should apply the same public noticing rules for proposed acquisition applications. While not every acquisition application may include a request to increase rates at the time the acquisition is approved, public noticing as stated in Rule 3.2(d) should still be a requirement.

For advice letter filings, the revised framework should apply the public noticing rules from GO 96-B General Rule 4.2:

Unless no notice or a shorter notice period is authorized by statute or Industry Rule or other Commission order, a utility shall give affected customers at least 30 days’ notice before the effective date of an advice letter requesting higher rates or charges, or more restrictive terms or conditions, than those currently in effect. This notice requirement may be satisfied by one or a combination of the following: bill inserts; notices printed on bills; separate notices sent by first-class mail; or electronic mail (e-mail) when a customer has affirmatively consented to receive notice in this manner. Notice by first-class mail is complete when the document is deposited in the mail, and notice by e-mail is complete upon successful transmission. Where authorized by the appropriate Industry Rules, the notice requirement may also be satisfied by notices printed in a newspaper of general circulation.

As with applications, an acquiring utility might defer rate increases in the advice letter filing to a later period. Deferring rate increases does not exempt the acquiring utility from the public noticing requirements stated here.

Public notice for both an application or advice letter filing should contain an explanation of the proposed acquisition, a comparison of the rates before and after the acquisition, an explanation of the Commission process, and instructions for customers seeking participation or more information. A draft proposed notice should be included as part of the Prefiling Conference for Water Division review.

For proposed acquisitions involving failing or at-risk water systems, adhering to the public noticing rules should be completed at the lowest cost option to provide adequate notice to affected customers. Since the review of acquisitions of failing or at-risk systems may be urgent or may result in no material ratepayer impact, the public noticing requirement should be met with minimal costs. This flexibility would allow for an expedited process and may serve as an incentive for Water IOUs to acquire failing or at-risk water systems.

Rate Deferment

Acquiring utilities would still be allowed to defer implementing the rate increases from an approved acquisition to a subsequent GRC, especially if the resulting rate increase is significant. Two benefits of continuing this policy of rate implementation deferral are to minimize customer confusion over multiple rate increases and to decrease the number of times the ratepayers see an overall change in their rates. However, the rate impact analysis and public noticing requirements mentioned above would still be applied to all acquisitions. Deferring rate increases without providing a rate impact analysis or public notices would not allow the Commission or ratepayers to consider the true cost of the proposed acquisition at the time of approval.

Quantifying Ratepayer Benefits and Costs

The Existing Framework does not provide clear guidance on how the Commission should examine ratepayer impacts due to an acquisition. Historically, the Commission applied two different standards in its review of acquisitions. One standard is the Ratepayer Indifference Test, which requires that an acquisition should not cause a ratepayer to prefer the acquiring utility to the acquired utility. The quality and continuity of service should be unaffected. The other standard is the Tangible Ratepayer Benefit, which requires an acquisition to deliver a net benefit to ratepayers. Acquiring utilities in current acquisition proposals often state benefits that could be defined as tangible but are not quantifiable, such as enhanced management and operation expertise. In order to ensure ratepayer impacts are thoroughly reviewed in a proposed acquisition, the Commission should require acquiring utilities to present quantifiable benefits in acquisition proposals.

Through the revised acquisitions framework, the Ratepayer Indifference Test should continue to be applied to acquisition proposals to ensure the acquiring utility maintains continuity of the existing water service. The current term for “Tangible Ratepayer Benefit” should be changed to the “Quantifiable Ratepayer Benefit.” For a ratepayer benefit to be considered for review by the Commission in a proposed acquisition, the

benefit must be quantifiable. An acquiring utility simply stating that the ratepayers from the acquired utility will receive improved quality of service would be insufficient. Quantifying the benefits puts the responsibility on the acquiring utility to detail evidence to the Commission that ratepayers will benefit from an acquisition. This proposal would increase transparency for impacted ratepayers and allows the Commission to better assess the reasonableness of the acquisition proposal.

An often stated benefit by the acquiring utility in an acquisition proposal is increased economies of scale. The acquiring utility would state that increasing the overall customer base through an acquisition would allow the spreading of potential costs from the proposed acquisition and would minimize ratepayer impacts. While the increased economies of scale as a potential benefit in a proposed acquisition should be recognized, the revised framework should require that the acquiring utilities in a proposed acquisition to measure the economies of scale. For example, a question that should be answered by the acquiring utility in a proposed acquisition is how much the customer bills would differ for the acquired utility through approval of this acquisition. The same question should also be answered for the impact to customer bills of the acquiring utility.

The revised framework should require both the Ratepayer Indifference Test and Quantifiable Ratepayer Benefit standards to be applied when reviewing an acquisition. However, similar to the public noticing requirements, the framework should allow flexibility when an acquisition involves a failing or at-risk water system. In these cases, the benefits of prioritizing clean, safe, and reliable water are evident although these standards may come with increased costs. However, when an acquiring utility is acquiring a non-failing or not at-risk system, the two standards should be applied for a proposed acquisition.

Reporting and Scheduling

Reporting Requirements

Through the Existing Framework, the reporting requirements²³ for applications and advice letters involving water utility acquisitions include the following:

- 1) Appraisal
- 2) Proposed rates
- 3) Purchase Agreement
- 4) Service area map (mutual and governmental acquisitions only)
- 5) Notice to customers
- 6) Service list

Section 2.04 of the Existing Framework requires that each application should include a forecast of the Result of Operations for the first and fifth years following the acquisition that impacts the acquiring and acquired utilities. Section 2.05 requires an appraisal to be completed with acquisition proposals. Sections 2.06 and 2.07 require appraisals to distinguish assets involved in acquisitions funded by state or federal government and/or contributions. From Sections 3.01 and 3.02, in order for a utility to request an acquisition of a failing or at-risk water system through the advice letter process, the utility must indicate the drinking water compliance orders that the failing or at-risk system are subjected to.

The reporting requirements for water utility acquisitions were previously expanded in D.20-08-047,²⁴ with the summary that follows and a full excerpt in Appendix A. Specific information on proposed rates such as monthly customer bill impact and estimated revenue requirement are now required in acquisition proposals. The acquiring utility must describe and provide supporting documentation of known and anticipated cost savings and efficiencies for the acquired utility. Further explanation and documentation of appraisals and valuations such as the methodology used for the specific acquisition proposal are required. Along with indicating any outstanding compliance orders from the SWRCB or US Environmental Protection Agency (EPA) the acquired utility may have, the acquiring utility must provide plans and estimated costs to remediate and bring the selling water system back into compliance. The applicant must identify ratepayer benefits for the existing customers of the acquiring utility.

The revised framework continues with these existing reporting requirements with the addition of a trend analysis on water system valuations and a history of recent rate increases as discussed in the Valuation Methods and Ratepayer Impact Analysis Sections, respectively. To enforce the reporting requirements, the application and advice letter filings for acquisition proposals would be subject to Commission rejection without prejudice if reporting requirements are not met. To prevent reporting issues under the revised

²³ Page 6 of the Existing Framework titled “Requirements for Applications and Advice Letters.”

²⁴ Pages 89-93.

framework, utilities would provide preliminary reporting requirements to Water Division for review at the Prefiling Conference²⁵.

While an advice letter is being reviewed by Water Division staff, the utility is responsible to reply to any data requests from Water Division staff in a reasonable amount of time. The revised framework allows utilities 10 business days to respond to data requests from Water Division. Providing a response beyond the 10 business days may delay the review process of the proposed acquisition. If such instance were to occur, Water Division would be granted an extension of the review deadline for a proposed acquisition.

During the review of an acquisition proposal, the revised framework supports coordination between the Commission and the SWRCB to confirm any outstanding compliance issues of a failing or at-risk water system and incorporate any concerns the SWRCB may have with the acquisition proposal. This topic is further discussed in the Coordination with SWRCB section. As proposed and supported by Cal Advocates in Workshop #1²⁶, the revised framework requires acquiring IOUs to conduct feasibility studies of potentially acquiring nearby failing or at-risk systems. Such feasibility studies would be submitted concurrently with each proposed acquisition filing. In instances where multiple acquisition applications are submitted within the same year by the same IOU, the submission requirement may be waived after the first feasibility study is submitted. This requirement is intended to advance the Commission's Environmental & Social Justice Action Plan and the SWRCB's Human Right to Water policy.

Scheduling

The Existing Framework provided 245 days for a water system acquisition application to have a decision placed on the Commission's agenda and 100 days for an advice letter to have a resolution for Commission consideration. Effective January 1, 2022, new legislation²⁷ was adopted that provided deadlines for the Commission to review acquisitions involving failing or at-risk water systems. Under Pub. Util. Code Sections 2721-2722, the Commission must approve or deny an application within 12 months and must approve or deny an advice letter for acquisitions involving failing or at-risk water systems within 180 days.

Through Pub. Util. Code Section 851, a utility is allowed to file an advice letter instead of an application if the water system being acquired is valued at \$5 million or less. If the advice letter is not protested, Pub. Util. Code Section 851 states that the Commission must approve or deny the acquisition within 120 days of filing.

In accordance with the statutory requirements, the revised framework allows the Commission up to 12 months to review an acquisition application involving a failing or at-risk water system and 180 days for an advice letter filing. If the advice letter filing involves a water system valued at \$5 million or less and is

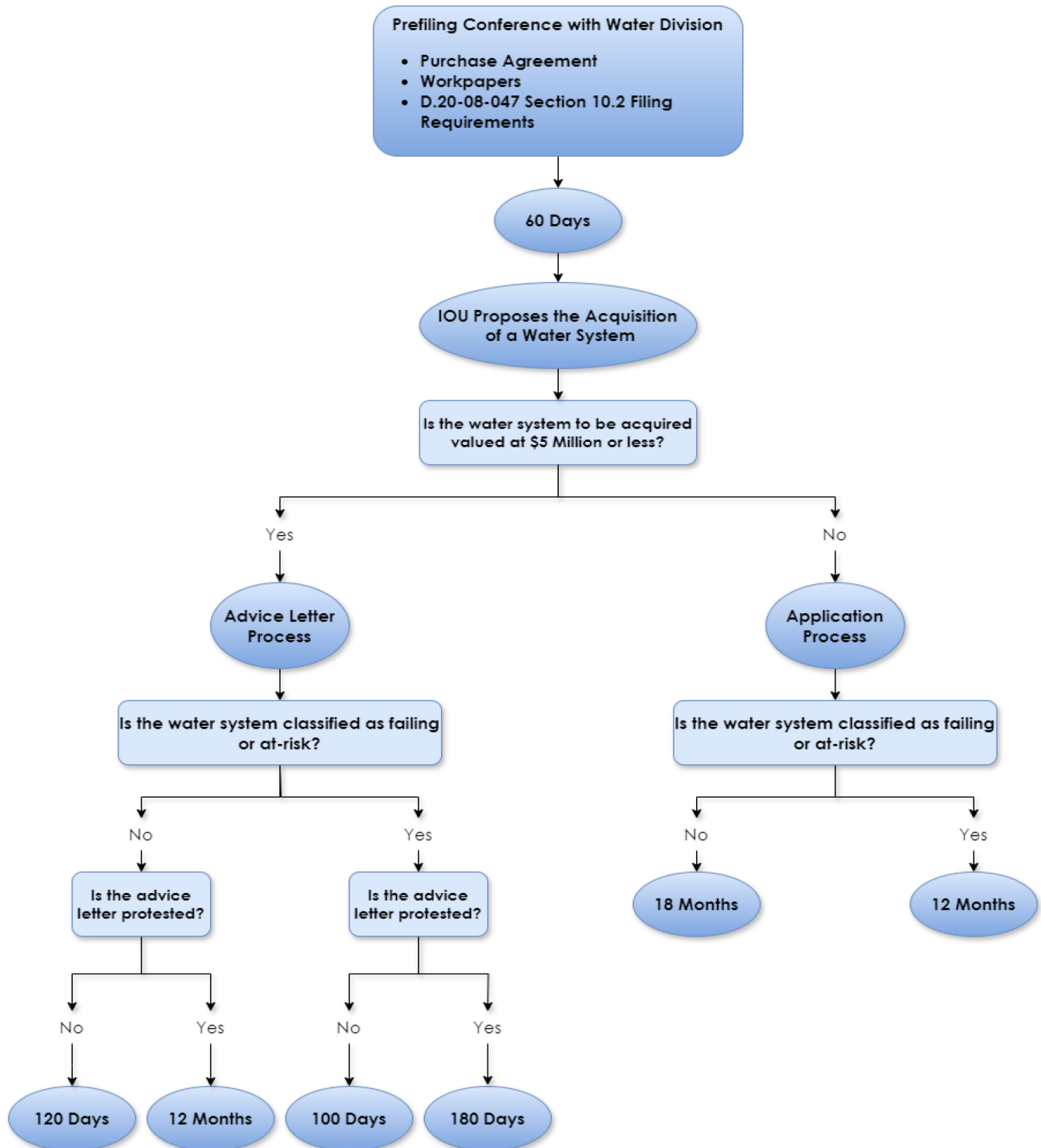
²⁵ A water utility that plans to file an acquisition request to the Commission must meet with Water Division at least 60 days before filing to discuss the proposed acquisition and provide proper documentation.

²⁶ Cal Advocates' Opening Comments on Workshop 1, pg. 3.

²⁷ Assembly Bill 1250, Calderon

unprotested, the Commission should be allowed up to 120 days to review. Figure 2 provides a flowchart outlining the proposed timeline.

Figure 2: Proposed Schedules for Acquisitions Filed with the Commission



For acquisitions involving non-failing or not-at-risk systems, the revised framework allows for a longer review period. This would incentivize acquisitions involving a failing or at-risk water system. For the review period of acquisitions involving non-failing or not-at-risk systems, the Commission should be allowed up to 18 months for applications, as this is consistent with the timeframe of a GRC for the larger Class A IOUs. Since the review period of an application was increased by 6 months, the same amount should be increased for advice letter filings. The revised framework allows the Commission 12 months to review advice letters involving acquisitions of non-failing or not-at-risk systems.

For an advice letter requesting to acquire a water system valued under \$5 million and that is untested, the revised framework provides an incentive to acquire failing or at-risk systems by reducing the review period to 100 days. For acquisitions involving non-failing or not-at-risk systems, the 120 day review period from the Existing Framework should remain.

This expedited timeframe proposal is supported by CWA, which proposed in its Workshop #4 presentation tiered review schedules based on the value of the water system to be acquired; its status as a failing or at-risk system; and if an acquisition application or advice letter is protested.

After a decision or resolution is approved authorizing a proposed acquisition and expanding the acquiring utility's Certificate of Public Convenience and Necessity (CPCN), the new rates and corresponding tariffs resulting from the acquisition are not yet implemented and in effect. To implement the new rates and tariffs, the current Commission process requires the decision or resolution to order the acquiring utility to file an advice letter to Water Division, and the approval timing is usually dependent on the acquiring utility obtaining a permit from the SWRCB to operate the acquired utility. To maintain a consistent process, the Revised Framework clarifies that this required advice letter will be designated as a Tier 1, and the acquiring utility must file to implement the new rates and tariffs within 30 days from the issuance date of the operating permit from the SWRCB. If an operating permit was already obtained or not required, the acquiring utility must file the advice letter within 30 days from the issuance date of the decision or resolution. The effective date should be the date of the advice letter filing. For authorized acquisitions where the new rates are deferred to the next GRC or a later date, the acquiring utility still needs to file a Tier 1 advice letter to Water Division to update the tariffs to include service to the newly acquired system.

Coordination with SWRCB

Communication Improvement

To enhance the acquisition process, communication between the Commission and SWRCB should be improved to address key inflection points. These points include notifications when grant funding applications are received, potential acquisitions identified in the GRC Minimum Data Requirements (MDR), and the identification of Water IOUs that are undergoing an acquisition. Staff suggest that the existing Memorandum of Understanding (MOU) between the agencies be revisited, and a Joint Task Force, previously informally started, be established as proposed by Cal Advocates. The aim is to foster better communication and coordination between the Commission and SWRCB. This is supported by the SWRCB, CWA and Rural County Representatives of California (RCRC).

- The updated MOU should establish clear communication protocols between the SWRCB and Commission, outlining regular meetings, reporting mechanisms, and channels of communication. This would ensure that relevant information is shared promptly and that both agencies are kept informed throughout the acquisition process.
- The MOU should formalize the establishment of a Joint Task Force consisting of staff members from both agencies. This task force would serve as a dedicated platform for regular coordination, collaboration, and exchange of expertise, aiming to streamline the acquisition process, resolve challenges, and identify areas of improvement.
- The updated MOU should include provisions for data sharing between the SWRCB and Commission. This could encompass sharing relevant information, reports, studies, and analyses related to acquisitions, grant funding applications, and water system evaluations. Ensuring a comprehensive exchange of data would facilitate better decision-making and alignment of priorities between the agencies.
- The MOU should outline a commitment to streamline processes by establishing joint procedures and timelines for acquisition reviews, grant funding approvals, and related administrative tasks. By aligning processes and avoiding unnecessary duplication of efforts, the updated MOU would enhance efficiency and reduce delays in the acquisition process.

Development of Shared Documents and Data

To streamline the acquisition process, the Commission should collaborate with the SWRCB to develop shared documents and data. For the Commission, this includes maintaining a record of ongoing acquisitions under review and compiling a list of potential acquisitions from the GRC MDR. Additionally, shared data may be created by the SWRCB for grant funding applications received and under review. Annual Reports filed by water IOUs to the Commission could be expanded to include necessary data for determining the status of proposed acquisitions and review of grant funding. The SWRCB, Large IOUs, CWA, Cal Advocates, Center for Accessible Technology (CforAT), and RCRC support this collaborative approach to document and data sharing. By having shared documents and data, the agencies can optimize their processes and improve efficiency.

To aid with the acquisition process, the following additions to annual reports filed to the Commission are recommended:

1. **Potential Acquisition Opportunities:** Identifying potential acquisition opportunities within the Commission's jurisdiction. This information would help both the Commission and SWRCB stay informed about potential acquisitions and enable them to coordinate their efforts in assessing and facilitating the acquisition process.
2. **Status of Current Acquisition Applications:** Providing an update on the status of ongoing acquisition applications, including whether they are under review, approved, or pending further action. This information would enable the SWRCB and other stakeholders to stay informed about the progress of acquisition projects and coordinate their efforts accordingly.
3. **Progress of Previous Acquisitions:** Including a section on the progress and outcomes of previous acquisition projects would provide valuable insights into the successes, challenges, and lessons learned from past efforts. This information would help refine and improve future acquisition processes and ensure continuous learning and improvement in the overall acquisition framework.
4. **Community Engagement and Stakeholder Feedback:** Including information on community engagement efforts and stakeholder feedback would provide a comprehensive view of the acquisition process's social and community impact. This could involve summarizing public hearings, community input, and any concerns or issues raised by stakeholders during the acquisition process.
5. **Environmental and Social Justice Considerations:** Incorporating an assessment of environmental and social justice considerations related to acquisitions. This would involve evaluating the potential impact of acquisitions on environmental resources, such as water sources, ecosystems, and sensitive habitats. Additionally, the report could highlight how the acquisition process aligns with principles of social justice, including equitable access to safe and reliable water services, particularly for disadvantaged communities. Including this information would ensure that environmental and social justice aspects are explicitly considered and integrated into the acquisition process, promoting sustainable and equitable outcomes.

Grant Funding Procedure

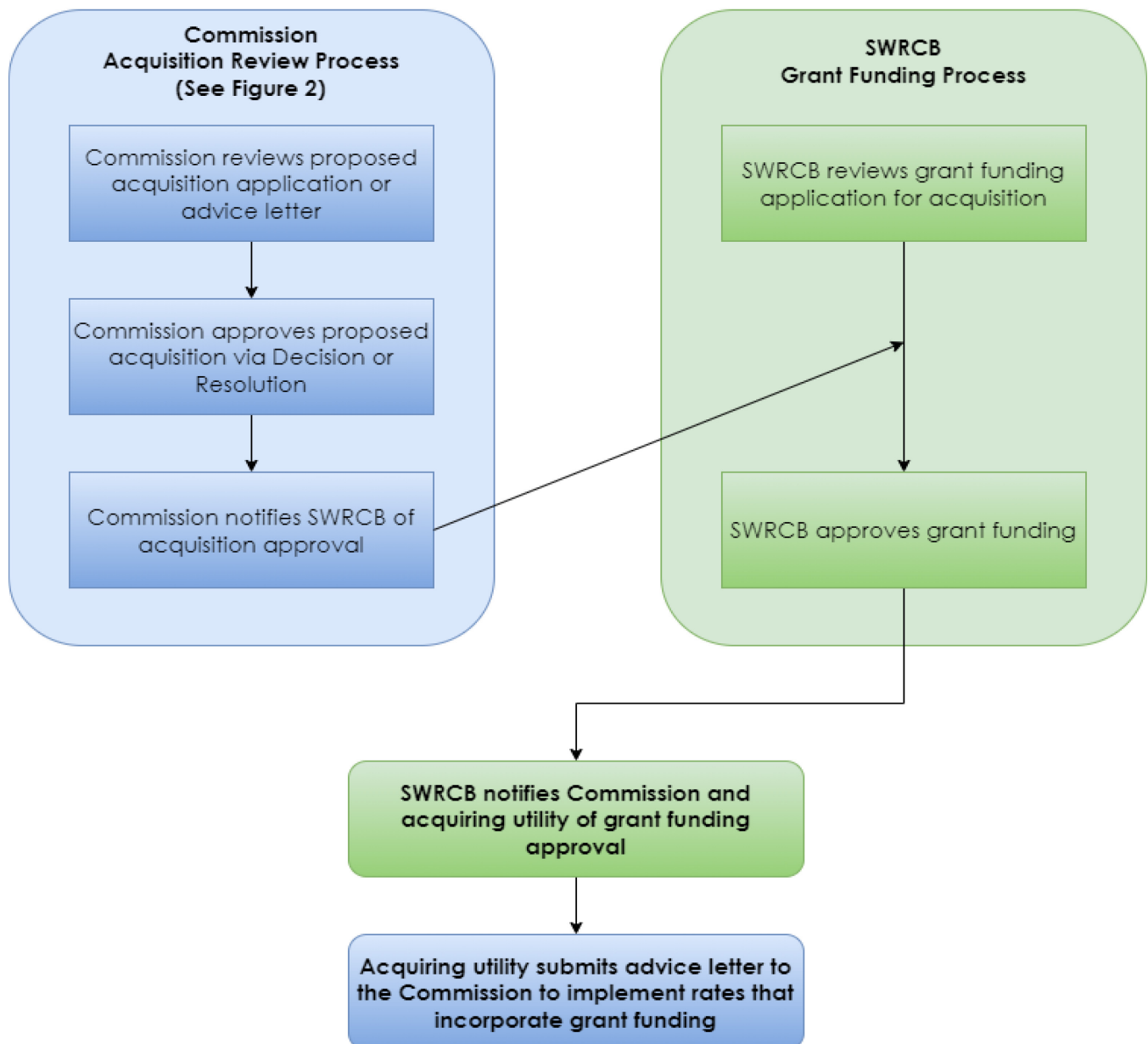
The grant funding process for water utility acquisitions could be improved by implementing a clear and sequential approach that ensures efficient coordination between the Commission and SWRCB. The proposed steps are as follows:

Grant funding and the acquisition approval process would be treated as independent processes to ensure clarity and streamline the regulatory framework. Grant funding focuses on securing financial assistance for specific projects and improvements, while the acquisition approval process evaluates the overall viability and benefits of the acquisition itself. Keeping these processes separate allows for a more efficient and targeted approach. This approach ensures that both processes may progress concurrently, enabling utilities to secure grant funding and obtain acquisition approvals in a manner that aligns with their respective requirements and timelines.

To streamline this process, the Commission would first issue a decision or resolution authorizing the proposed acquisition which would include granting the CPCN to the acquiring utility on condition the grant funding is approved by the SWRCB. The Commission would then follow up with the SWRCB on their

completion of the grant funding approval process. Once grant funding is approved and the SWRCB notifies the Commission and the acquiring utility, the acquiring utility would then proceed in finalizing the acquisition by filing an advice letter to implement the new rates. Figure 3 illustrates this procedure. This advice letter would reflect the financial impact of the acquisition and inclusion of the grant funding, ensuring that the rate adjustments accurately account for the improved infrastructure and operational efficiencies resulting from the acquisition.

Figure 3: Proposed Grant Funding Procedure



Acquisitions Involving Non-IOUs

The Existing Framework does not provide clear guidance on how the Commission should review an IOU acquisition involving a mutual or municipally-owned water system. Section 4.01 from the Existing Framework states that Commission authorization is not required under Pub. Util. Code Section 852 and 854 for these types of acquisitions. The only guidance provided in the Existing Framework is that an advice letter should be filed to implement existing or lower rates; provide notice of the acquisition to customers; and require the utility to file an application if there is long-term financing involved.

Pub. Util. Code Section 10061 addresses how a municipality may authorize the sale of its own water or sewer system. Section 10061(c)(3) requires the sale to be approved by a majority of all voters in a special or general election. Section 10061(c)(4) requires the acquiring utility to disclose to the municipal customers 30 days before the election the following:

- (A) Summary of the purchase agreement
- (B) Rate comparison before and after the proposed acquisition
- (C) Estimated savings or additional costs resulting from the proposed acquisition

Pub. Util. Code Section 10061 does not address the Commission's role in reviewing the sale of a municipally-owned water system to a water IOU.

Even though statutory language does not require acquiring utilities to seek Commission authorization of acquisitions involving mutual or municipals by IOUs, the revised framework requires utilities to seek Commission authorization for these types of acquisition proposals. The Commission review process would consist of the same processes as an acquisition between two IOUs. As an additional step in the review process, the Commission would ensure that the acquisition of a mutual or municipal water system complies with Pub. Util. Code Section 10061 and other local government regulations, including coordination with the local agency formation commission (LAFCO). The revised framework encourages coordination between the Commission and LAFCOs early in the acquisition process.

When an acquisition involves an IOU being acquired by a mutual or municipal water system, there is no statutory requirement that requires the Commission to review the proposed acquisition. However, to properly document the acquisition, the Commission needs to issue a Resolution accepting the acquisition and formally revoke the CPCN of the IOU being acquired. The revised framework requires the IOU being acquired to file a Tier 3 advice letter to the Commission detailing its acquisition by a mutual or municipal and to terminate its Certificate of Public Convenience and Necessity. All the reporting requirements for a proposed acquisition should still be required. This process should still apply if an IOU is involved in an eminent domain case.

Appendix A: D.20-08-047 Reporting Requirements

Commission Decision (D.) 20-08-047 approved the below expanded reporting requirements for acquisitions:

1. Estimate the potential monthly incremental cost impact on existing and acquired customers following the actual results of the Buyer's most recently authorized tariffs.
 - a. If a Buyer has pending request before the Commission to change rates, it must also calculate the above using data as proposed in its pending request.
2. If the Buyer is seeking authority to increase the acquired system's rates to a certain level, please state the basis for the targeted rate and period of time for such targeted rate to be implemented.
3. Provide the annual depreciation expense using the proposed rate base of the acquired assets. If the exact depreciation expense is not available, provide the best estimate of the annual depreciation expense. Show how the depreciation expense is calculated.
4. Provide an estimate of the annual revenue requirement of the system proposed to be acquired. Provide the assumptions for the annual revenue requirement, including expected rate of return, expected depreciation expense, O&M expenses, etc.
5. Other than the revenue requirement data requested above, separately identify all other approved and/or intended impacts to customer bills (i.e., surcharges, passthrough fees, etc.).
6. Provide a listing of any entities that currently receive free service from the acquired utility.
7. If the acquired utility has increased rates in the last year, please state the date of the increase and provide a copy of the new rate schedule and the total annual revenues projected under the new rates.
8. Are there any leases, easements, and access to public rights-of-way that Buyer expects to be needed in order to provide service which will not be conveyed at closing? If yes, identify when the conveyance will take place and whether there are expected to be additional costs involved.
9. Provide a breakdown of the estimated transaction and closing costs. Provide invoices to support any transaction and closing costs that have already been incurred.
10. Describe known and anticipated general expense savings and efficiencies under Buyer's ownership. State the basis for assumptions used in developing these savings and efficiencies and provide all supporting documentation for the assumptions.
11. Provide a copy of the Seller's request for proposals (if there was one) and any accompanying exhibits with respect to the proposed sale of the water system or water system assets.
12. Provide a copy of the response to the request for proposals (if there was one) of the Buyer for the purchase of the acquired water system or water system assets.
13. For each Utility Valuation Expert (UVE) providing testimony or exhibits, please provide the following:
 - a. A list of valuations of utility property performed by the UVE in the last two years;
 - b. A list of appraisals of utility property performed by the UVE in the last two years;
 - c. A list of all dockets in which the UVE submitted testimony to a public utility commission or regulatory authority related to the acquisition of utility property in the last two years; and
 - d. An electronic copy of or electronic link to written testimony in which the UVE testified on public utility fair value acquisitions in the past two years.

14. Explain each discount rate used in the appraisals and valuations, including explanations of the capital structure, cost of equity and cost of debt. State the basis for each input. Provide all sources, documentation, calculations and/or workpapers used in determining the inputs.
15. Explain whether the appraisal/valuation used replacement cost or reproduction cost and why that methodology was chosen.
16. Explain the basis for any comparable acquisitions used in the appraisal/valuation including the purchase price and number of customers for each comparable acquisition.
17. Are there any outstanding compliance issues, including but not limited to water quality violations, that the Seller's system has pending with the Board's Division of Drinking Water? If yes, provide the following information:
 - a. Identify the compliance issue(s);
 - b. Provide an estimated date of compliance;
 - c. Explain Buyer's anticipated or actual plan for remediation;
 - d. Provide Buyer's estimated costs for remediation; and,
 - e. Indicate whether the cost of remediation was or is anticipated to be factored into either or both fair market valuation appraisals offered in this proceeding.
18. Are there any outstanding compliance issues that the Seller's system has pending with the US Environmental Protection Agency? If yes, provide the following information:
 - a. Identify the compliance issue(s);
 - b. Provide an estimated date of compliance;
 - c. Explain Buyer's anticipated or actual plan for remediation;
 - d. Provide Buyer's estimated costs for remediation; and
 - e. Indicate whether the cost of remediation was or is anticipated to be factored into either or both fair market valuation appraisals offered in this proceeding.
19. Provide copies of all notices of a proposed acquisition given to affected customers.
20. Provide copies of all disclosures and customer notices required by Pub. Util. Code § 10061 related to the sale and disposal of utilities owned by municipal corporations.
21. Describe other requests to be included in the application, including but not limited to requests for approval of:
 - a. Consulting, transition of service, water wholesaling, or other agreements;
 - b. Interim rate increases outside of a general rate case proceeding or other special rate treatment (e.g., CPI-U rate increases, or rate increases under Class C/D requirements);
 - c. Facilities construction;
 - d. Memorandum or Balancing Accounts.
22. Identify the ratepayer benefits that accrue to current ratepayers of the system being acquired due to this transaction.
23. Identify all actions the applicant has taken with governmental agencies related to obtaining required permits and/or approvals to effectuate the acquisition.
24. Provide all workpapers that support the testimony for each of the witnesses that accompany the application, in native format where possible.

The Commission also found that the following information, when presented as part of the application or with the MDR and subsequently included in the record will help streamline consideration of an application for consolidation:

- A list of recommended, proposed or required capital improvements to the acquired water system known at the time of the application, with cost estimates, if available;
- If applicable, supporting documentation for the designation of Disadvantaged Community; and
- If applicable, documents required by Pub. Util. Code Section 10061(c).

(END ATTACHMENT A)