BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to review the existing guiding framework set forth in Decision 99-10-064 (consistent with the Public Water System Investment and Consolidation Act of 1997) regarding acquisitions involving water utilities under the Commission's jurisdiction.	Rulemaking 22-04-003

COMMENTS OF THE PUBLIC ADVOCATES OFFICE ON ORDER INSTITUTING RULEMAKING

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I. INTRODUCTION

With the current rulemaking (R. 22-04-003), the Commission embarks on a much-needed reassessment of the processes and policies applicable to investor-owned water utilities' (water IOUs) proposals to buy or sell water systems. The existing framework governing water IOUs' acquisitions emanates from a previous rulemaking opened twenty-five years ago and a settlement agreement among just over half of the participating parties—many of which no longer exist as entities today.[1] The well-researched Staff White Paper attached to the current rulemaking[2] summarizes subsequent developments and highlights unanswered questions and gaps in the existing framework that the Commission must address to effectively oversee water IOUs' proposed acquisitions and protect the public interest.

Since the number of proposed water system acquisitions by water IOUs is likely to increase,[3] it is imperative that the Commission establish fair and equitable rules that protect ratepayers from the abusive practices that too easily result from the absence of competition and market forces. In fact, the Commission should establish its fundamental role as a substitute for competition in transactions in which water IOUs acquire other water utilities. Unlike in a competitive environment where an overvalued acquisition places a company at a competitive disadvantage subject to loss of revenue and profit, acquisitions by water IOUs are wholly underwritten by a captive customer base that must fund not only the acquisition price but an authorized profit percentage on every dollar of that price.

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[1] See D.99-10-064 https://docs.cpuc.ca.gov/PublishedDocs/PUBLISHED/GRAPHICS/82570.PDF.

[2] A Revised Framework for Water Utility Acquisition, March 2022. https://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M468/K803/468803536.PDF

[3] In 2021, the State Water Resources Control Board identified over 600 water systems in California that were at-risk of failing to sustainably provide enough safe and affordable drinking with approximately 47 new systems identified each year. https://www.waterboards.ca.gov/drinking_water/certlic/drinkingwater/documents/needs/executive_summary.pdf

In addition to ensuring that no acquisition by a water IOU results in unfair customer rates or unreasonable monopoly profits, the Commission must establish rules that require the rate impacts of proposed acquisitions to be transparent. Currently, water IOUs can provide "illustrative" rate impacts in acquisition applications without specifically requesting the necessary rate changes to fund the acquisition. While this enables water IOUs to "inform" customers that the proposed acquisition does not include rates changes, these "illustrative rates" mask the unavoidable rate impacts that would result from the acquisition. In addition to obfuscating the proposed acquisition's rate impacts, omitting rate requests from acquisition applications paves the way for establishing unnecessary memorandum and balancing accounts. These accounts then guarantee that water IOUs will later request ratepayer recovery of any costs associated with the acquisition (not just those anticipated and identified in the application).

By addressing deficiencies in its existing framework to review and approve water IOUs' proposed acquisitions, the Commission can improve the acquisition process and take tangible steps towards meeting the goal of safe and affordable water for all. Unreasonable rate revenue and monopoly profit can be redirected to assist greater numbers of threatened and at-risk water systems. Underserved communities can benefit from the technical, managerial, and financial resources of regulated investor-owned water utilities capable of mitigating the impacts of necessary system improvement costs through relatively larger customer bases. And with equitable and unambiguous rules in place to limit the contentiousness of water IOU acquisition proceedings, Californians without safe and reliable water service can more quickly and efficiently receive the relief that is so desperately needed.

The Public Advocates Office at the California Public Utilities Commission (Cal Advocates) appreciates the opportunity to participate in this rulemaking and respectfully submits the following comments and recommendations for the Commission's consideration.

II. FOUNDATION FOR AN ACQUISITION FRAMEWORK

Any framework for Commission review of water IOU acquisitions must be based on reasonableness. Deceptively simple, an acquisition framework built on a foundation of reasonableness offers very important implications. First, if the results of a particular method are unreasonable, regardless of the established provenance or general acceptability of the method, the Commission must consider other legally permissible alternatives that would produce a reasonable outcome. Likewise, any method demonstrated to be intrinsically unreasonable should cause the Commission pause, even if the results appear reasonable. This is especially important when considering the consolidation of water utilities and the resulting increase in the customer base. The increased customer base allows costs to be spread among more customers, decreasing, the relative size of individual customer impacts. Therefore, with each acquisition it becomes increasingly important for the Commission to not overlook questionable methods, analyses, and utility requests simply because the impacts to any individual customer appear small in one specific application.

California Public Utilities Code section 451 requires that all rates charged to customers be "just and reasonable."[4] Importantly however, that code section does not define or explain what is meant by "just" or "reasonable." This is especially relevant to the Commission's current proceeding to establish rules governing acquisitions by water IOUs. No matter how specific or comprehensive the rules established in this proceeding are, scenarios and issues that fall outside the established parameters will certainly arise in future acquisition proceedings. Much like any other issue of significance before the Commission, no set of rules, specifications, or well-intentioned checklists, will ever provide a reliable substitute for deliberate and thoughtful decision-making based upon the facts and circumstances available. In fact, recognizing the futility of attempting to develop rules covering every possible issue or scenario that may arise in future

[4] Pub. Util. Code § 451.

acquisition proceedings should allow the Commission to move forward expeditiously in adopting principle-based, common-sense, recommendations such as those presented below by Cal Advocates.

1. Better Data Yields Better Valuations

A valuation of the water system being acquired is one of the most, contentious, yet essential, aspects of an acquisition proceeding. The valuation informs the reasonableness of the acquisition price, which ultimately dictates what customers must pay. However, the valuation of a water system has somewhat unusual characteristics—and the valuation of a water system that is or will be operated as an investor-owned monopoly under rate-of-return regulation has very unusual characteristics that the Commission must consider carefully. There is rarely an exact substitute for a water system, but the same is true for most real property. However, when an acquisition involves an investor-owned monopoly, the economics of rate-of-return regulation introduce additional challenges to the valuation process.

Under rate-of-return regulation the only profit included in what customers pay is a fixed percentage of a utility's capital spending. As a utility spends more on assets, the more profit a utility can expect to receive. This fact can distort, if not eliminate, the natural tension between a seller seeking to maximize a selling price and a buyer seeking to minimize the price. As a buyer, an investor-owned utility has a reduced (and some might say negative) financial incentive to pay the lowest possible price. Because this reduced incentive exists for any capital spending, the Commission routinely examines the reasonableness and prudence of utility spending. But unlike most of the pumps and pipes water utilities purchase in a competitive marketplace, there is rarely an exact substitute for an entire water system. A lack of an exact substitute and a reduced incentive for paying the lowest price means that the Commission must carefully evaluate the value of a water system that is the target of a water IOU's proposed acquisition.

Although there is no universal valuation methodology that can replace thoughtful analysis and deliberation, the use of better valuation data would make the process of evaluating acquisition applications more efficient and less contentious. In 1997, the

Public Water System Investment and Consolidation Act ("Consolidation Act") identified reproduction cost as a valuation methodology to be employed in acquisition proceedings.[5] According to the Consolidation Act, a proposed acquisition price that exceeded reproduction cost might be authorized by the Commission depending on certain considerations.[6] Unfortunately, this has been frequently misinterpreted as any proposed acquisition price *less than* reproduction cost is *de facto* reasonable and must be approved by the Commission.

Similarly, a portion of the Consolidation Act references the fair value of an acquired water system to be used for rate setting purposes as the highest price that would be agreed to by a willing buyer and willing seller.[7] While the price agreed to by a willing buyer or willing seller might be the fair value of the system, the Consolidation Act also points to fair value being determined by any method of valuation that is just and equitable when there is no relevant, comparable market. Therefore, the pivotal question becomes how to determine if the agreed to price reflects what would have been produced in a relevant, comparable market.[8] With better valuation data required in an acquisition application, this question should be easier and less contentious to answer.

There are many standard valuation methods that can be used to appraise the value of a water system. In fact, the Public Utilities Commission of Pennsylvania requires all acquisition applications to contain two separate valuations performed by two different utility valuation experts using three different valuation methods.[9] Although California's Consolidation Act mentions only the reproduction cost method, the Commission could also require water IOUs to submit valuations using additional methods. In fact, requiring

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[5] Pub. Util. Code § 2720(b).

[6] Whether the acquisition will improve reliability, compliance with health and safety regulations, efficiencies and economies of scale, and whether the effect on customers is fair and reasonable. See Cal. Pub. Util. Code 2720(b).

[7] Pub. Util. Code § 2720(a)(2) referencing Section 1263.320(a) of the Code of Civil Procedure.

[8] For a recent discussion on fair market value versus cost less depreciation, see NARUC's 2021 https://pubs.naruc.org/pub/ED8E5710-1866-DAAC-99FB-B70190F3D64A

[9] Pennsylvania Public Utility Code 66 Pa. C.S. § 1329.

all California water IOU acquisition applications to provide the three standard valuation methods required by Pennsylvania (in addition to the reproduction cost method mentioned in the Consolidation Act) would better inform whether the water IOU's proposed acquisition price reasonably approximates the fair market value.

For example, if multiple standard valuation methods presented in an acquisition proceeding all point to a valuation significantly different than the water IOU's proposed acquisition price, it is reasonable to conclude that the proposed acquisition price does not reflect a price that would be negotiated in a relevant, comparable market. In this situation, the Commission should not accept the water IOU's proposed price as the fair market value but rather utilize any other method that is just and equitable consistent with provisions of the Consolidation Act. By requiring the submission of multiple standard valuation methods as part of the water IOU's acquisition application, the Commission would improve the record for determining fair market value in two important ways. First, the submission of multiple valuation methods provides evidence as to whether the agreed upon price reflects a relevant, comparable market. Secondly, the additional valuations provide useful data points for determining the fair market value in a just and equitable method if the negotiated price does not reflect fair market value.

In summary, the Consolidation Act is helpful in establishing that the proposed acquisition price agreed to by the water IOU *may* be the fair market value. However, the Commission does not currently require acquisition applications to provide adequate information to determine whether the agreed to price *is* the fair market value. Nor does the Commission require all the relevant data points necessary to determine what is the fair market value if it is not the agreed to price. The Commission can remedy both deficiencies by requiring water IOUs to submit valuations using the three standard methods required by the Public Utilities Commission of Pennsylvania [10] in addition to the reproduction cost method.

[10] Income Approach, Market Metrics (Comparable), and Cost Approach.

In acquisition proceedings, as in most Commission proceedings, better data yields better results. The Commission should revise the minimum data requirements previously established for all water utility acquisition applications to include valuations of any water system that a water IOU proposes to acquire, using the three standard methods required by the Public Utilities Commission of Pennsylvania performed by professional utility valuation experts.

2. Prevent Windfall Monopoly Profits

From its creation more than 100 years ago by constitutional amendment, the most fundamental role of the California Public Utilities Commission has been to protect the public from monopoly abuse. The most common form of monopoly abuse is the profiteering from captive customers for essential public services for which there is no reasonable substitute. The Commission's regulation of water IOUs recognizes these realities through establishing just and reasonable water utility rates in general rate cases and establishing fair and equitable rates of return in cost of capital proceedings. It is essential the Commission continue to provide this basic and fundamental protection during the acquisition process of water utility systems.

A water IOU that sells a water system will receive a gain or profit on the transaction if the fair value price exceeds the amount of actual investment in the system. If the system is acquired by another water IOU, the fair value price (including the gain to the seller) will be funded by ratepayers in order to provide the acquiring utility a principle return *of* the price paid[11] and a profit return *on* the price paid.[12] Importantly, it is the ratepayers that must fund both the gain to the selling water IOU and the profit return to the acquiring water IOU on that gain which is included in the acquisition price. While the profit return for the acquiring water IOU is limited by the authorized rate of return established by the Commission in cost of capital proceedings, the gain to the water IOU

[11] Depreciation costs assessed to ratepayers.

[12] The profit percentage included in utility rates.

selling the system has remained to date unlimited.[13] This is precisely the situation the Commission exists to prevent.

In 2006, the Commission established rules to share between utility owners and utility ratepayers the gain on the sale of utility assets.[14] Although the Commission has not applied these rules to the sale of an entire water system, conceptually there is little difference between the sale of all an investor-owned utility's assets (as in an acquisition proceeding) and the sale of one asset, two asset, one hundred assets, or even all assets minus one (as interpreted from the Commission's 2006 gain on sale rules). In both scenarios, assets funded by ratepayers for which a utility has already received a profit (which has also been funded by ratepayers) are sold for another profit. However, there is an important difference that makes sharing a gain with ratepayers critically more applicable to acquisition proceedings. Unlike the disposal of assets by a water IOU to a non-regulated entity as may be the case under the gain on sale rules, when a water IOU sells an entire system of assets to another water IOU, it is ratepayers that fund the gain on sale through increased rates. It is unreasonable to require the ratepayers to fund that entire gain on sale when the obligation would be eliminated for the sale of any other used and useful utility asset to a non-regulated entity.

Many regulatory jurisdictions throughout the United States have gain on sale rules. A survey conducted in 1994, identified that in most states surveyed "the gain is more often than not allocated to ratepayers, though shareholders are allocated some portion of the gain in about half of the commission responses."[15] To balance the rising cost to ratepayers of water system acquisitions with the Commission's policy preference for the consolidation of smaller water systems (which may at times require a seller's incentive), the Commission should establish rules applicable to the sale of water systems by an

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[13] In 2021, a windfall profit to be recovered from ratepayers of $30M on an initial investment of $4M was awarded to the sole shareholder of a California investor-owned-utility. https://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M398/K276/398276936.PDF

[14] https://docs.cpuc.ca.gov/PublishedDocs/WORD_PDF/FINAL_DECISION/57114.PDF

[15] *State Public Service Commission Disposition of the Gain on Sale of Utility Assets*, David. Wirick, 1994.

investor-owned water utility that apportions 33% of the after-tax gain on non-depreciable assets to utility owners and 67% to ratepayers. As is the case in most jurisdictions surveyed in 1994 and consistent with the Commission's 2006 gain on sale rules, 100% of the gain on depreciable assets should be allocated to ratepayers.

3. Fair Allocation of Acquisition Costs

The ultimate cost to ratepayers of an acquisition proceeding includes not only the acquisition price but also the cost of any necessary system improvements. Unlike the cost of system improvements that will presumably enable the provision of safe and reliable water service, the acquisition price—or more precisely the acquisition premium included in the acquisition price—represents an increased cost to ratepayers resulting only from a change of ownership. While spreading the cost of system improvements among the existing ratepayers of the acquiring utility may result in economies of scale and may be the price of California's human right to water, the same cannot be said for burdening ratepayers of the acquiring utility with an acquisition premium.

Although the Consolidation Act requires the entire acquisition price (including any acquisition premium) to be added to the rate base of the acquiring utility, no guidance exists on how that cost should be allocated between existing ratepayers and those acquired in the acquisition. For reasons rooted in sound economics and public policy, the Commission should allow the book value[16] of the acquired system and any necessary system improvements to be funded by all ratepayers of the combined system. The remaining portion of the acquisition price representing an acquisition premium (i.e. the difference between the acquisition price and the book value) should be funded by the ratepayers of the acquired system.[17]

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[16] Book value is the cost of carrying an asset on the balance sheet, and can also be thought of as the net asset value (NAV), calculated as total assets minus liabilities.

[17] Any gain on sale received by ratepayers of the acquired system would be available to immediately offset their funding of the acquisition premium.

Much has been written in Commission decisions, legislation, and regulatory research papers on the potential for economies of scale that can be achieved through consolidation of water systems.[18] While actual "economies of scale" may eventually result from lower unit costs of combined system operations, the term is often misapplied in water system acquisitions to refer to the simple act of spreading costs across a larger customer base without any cost savings at all. However, the misuse of the term becomes more pronounced when applied to spreading the acquisition premium of a purchased water system across a combined customer base. An acquisition premium results in increased costs for ratepayers solely from the act of purchasing and combining water systems. Far from being an economy of scale, increasing costs to all ratepayers by combining two entities into one larger entity without achieving any tangible benefits through that process is the literal definition of a diseconomy of scale.

Absent savings forecasted and reflected in future rates, any tangible benefit from the acquisition and consolidation of water systems arises *after* the acquisition price (and premium) is paid. It is only after the transaction when the presumed benefits of consolidation and alleged economies of scale can possibly occur—if they ever occur at all. So while it may be reasonable to require the existing ratepayers of the acquiring system to fund the book value of the system (which will be offset with the acquired system's revenues) and any necessary system improvements (which aligns with the human right to water and theoretically may offer economies of scale), it is not reasonable to burden existing ratepayers of the acquiring entity with the additional and avoidable cost of an acquired system changing ownership. The Commission should require any acquisition premium emanating from the acquisition of water system to be the funding obligation of the acquired system's ratepayers.

[18] See Commission Decision 21-08-002
https://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M398/K276/398276936.PDF

4. Require Transparency in Acquisition Applications

Almost all applications to acquire a water system contain a utility's illustrative rate impacts of the proposed transaction. However, few if any contain the actual request to implement rate changes. In contrast with the Commission's typical rate setting process of developing a forecast and implementing a budget through authorized rates that, if necessary, can be periodically adjusted, there is currently no forward-looking rate setting process in water system acquisition applications. This has deleterious effects on both the water IOU's incentives to control costs and the transparency of acquisition's impacts.

As a substitute for the traditional, forward-looking rate setting process, water IOUs have been able to implement alternative ratemaking mechanisms[19] in acquisition proceedings. These mechanisms allow a water IOU to operate without the discipline of a Commission-authorized budget. Rather, all costs associated with the acquisition are tracked in accounts that can be presented to the Commission for requested recovery from ratepayers at a future date. These costs include the acquisition price itself, which would be difficult to argue is unforecastable or beyond the water IOU's control—two criteria typically required for authorizing these type of tracking accounts.[20]

More importantly, by not requesting either the known or forecasted rate impacts of a proposed acquisition in the actual acquisition application, water IOUs have the duplicitous opportunity of informing customers that the application is not requesting any rate changes at all. This may limit public participation and seems rather disingenuous when the proposed acquisition price, if approved, must by law become the rate base upon which customer rates will be set. In fact, this is the opposite of transparency.

The Commission should require that all water IOU applications requesting approval of a water system acquisition also request the necessary rate changes to fund the acquisition and any necessary improvements occurring prior to the utility's next general

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[19] Primarily Memorandum and Balancing Accounts.

[20]. Commission Standard Practice U-27
http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M090/K002/90002198.PDF

rate case. If the water IOU has performed the required due diligence to arrive at a fair value price for the system it proposes to acquire, the water IOU should have reasonable forecasts to include both of these items in customer rates at the time an acquisition is approved. Doing so will provide the water IOU with an incentive to control costs and more importantly, will provide decision-makers and ratepayers the required transparency to understand the impacts of the proposed acquisition.

III. SUMMARY OF RECOMMENDATIONS

Cal Advocates appreciates the opportunity to participate in this proceeding and believes the common-sense, principle-based, recommendations of (1) Developing Better Data, (2) Preventing Windfall Monopoly Profit, (3) Fairly Allocating Acquisition Costs, and (4) Requiring Transparency, as referenced above, will greatly improve the efficiency and effectiveness of how the Commission processes water utility acquisition applications within the framework of protecting and promoting the public interest.

IV. ANSWERS TO SPECIFIC OIR QUESTIONS

4.1.1. Issue 1 – Price and Valuation

1. How should the value of a water utility system be determined in acquisitions?

The Commission should utilize a data-driven process that ensures reasonableness is the foundation for both method and result. See Section 1: Better Data Yields Better Valuations, above.

2. How should water rights be considered in water utility system acquisitions?

Water rights should be considered like any other asset being acquired within the framework of Cal Advocates' recommended gain on sale rules. See Section 2: Prevent Windfall Monopoly Profits, above. Similar to the proposed acquisition of other assets, water IOUS should demonstrate that the water rights are necessary in the operation of the combined water system as a used and useful asset. To the extent water rights will not be

a used and useful asset in system operations, it is inappropriate to include them in the transaction.

3. How could the Commission promote more consistent application of Code Civ. Pro. Sections 1263.320 (a) and (b) as applied to proposed water utility acquisitions?

In order to promote a more consistent application, the referenced code sections should be read in tandem consistent with the framework and recommendations of Cal Advocates. See Section 1: Better Data Yields Better Valuations, above. The data and valuations that Cal Advocates recommends as requirements in every acquisition application would help to identify the prevailing characteristic of the proposed acquisition so that the Commission could consistently apply Code Civ. Pro. Sections 1263.320 (a) and (b) to proposed water utility acquisitions How could Cost-Sharing procedures apply to water utility acquisitions?

See Cal Advocates recommendation, Section 3: Fair Allocation of Acquisition Costs, above.

4. Should utility assets and liabilities be treated in some standard manner for ratemaking purposes in proposed water utility acquisitions? If so, how?

Assets and liabilities appearing on financial records of the acquired system should be treated per the standard valuation methodologies referenced and recommended to be required by Cal Advocates in Section 1: Better Data Yields Better Valuations, above.

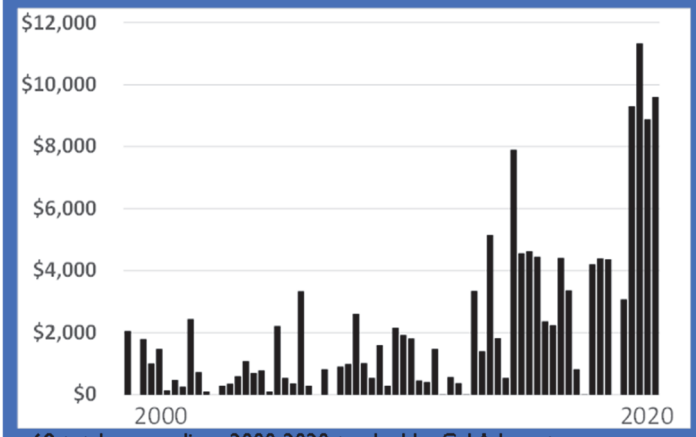
"Liabilities" not appearing on the financial records of the acquired system that represent necessary improvement in the acquired system to be made prior the acquiring utility's next general rate case, should be forecasted and included in customer rates at the time an acquisition request is approved.

5. Should there be a study or analysis conducted to examine the increasing purchase prices of water utility system acquisitions?

Cal Advocates created the follow graph using the Price Per Connection of sixty-eight recent water system acquisitions by investor-owned utilities over the period 2000-2020.[21]

To the extent other parties disagree that acquisitions prices have demonstrated an upward, increasing trend, Cal Advocates does not object to other studies being performed.

Table 1: Price Per Connection



68 total proceedings 2000-2020 tracked by Cal Advocates

Issue 2 – Ratepayer Impacts

6. How should the Commission examine ratepayer impacts when reviewing water utility acquisitions?

The Commission should examine and identify ratepayer impacts of utility acquisitions comprehensively and transparently consistent with the recommendations of Cal Advocates, see Section 4: Require Transparency in Acquisition Applications, above.

[21] Information from IOU applications to the CPUC are available upon request.

7. What test and criteria should be used to determine ratepayer impacts in water utility acquisitions, if any?

The Commission's criteria to determine ratepayer impacts should always be based in reasonableness. See Cal Advocates recommendations contained within the section, Foundation for An Acquisition Framework, above.

8. Should existing customers of the acquiring water utility be included in the review of ratepayer impact?

Yes. See the recommendations of Cal Advocates in Section 3: Fair Allocation of Acquisition Costs, above.

Importantly, existing customers should also be able to review the ratepayer impacts of the proposed acquisition. See the recommendation of Cal Advocates in Section 4: Require Transparency in Acquisition Applications, above.

9. How should the benefits and costs of water utility acquisitions be measured?

The benefits and cost of acquisition should be measured against all reasonable alternatives. See Cal Advocates recommendations contained within the section, Foundation for An Acquisition Framework, above.

10. How should rate impacts from previous acquisitions be assessed when reviewing a proposed water utility acquisition?

Rate impacts from previous acquisitions may be informative to understanding the overall burden ratepayers are or will be experiencing.

4.1.3. Issue 3 – Inadequately Operated and Maintained Systems

11. How should water utility acquisitions be prioritized for inadequately operated and maintained systems?

Cal Advocate's recommendations contained within the Foundation for An Acquisition Framework, above, should provide for more efficient and less contentious

acquisition proceedings, which allows more resources to be available for the prioritization of inadequately operated and maintained systems.

12. How should coordination efforts between the Commission and the SWRCB be improved on water utility system acquisitions and consolidations to address inadequately operated and maintained systems?

Current coordination efforts between the Commission and SWRCB (State Water Resources Control Board) have been highly effective in identifying inadequately operated and maintained systems. The Commission should strive to achieve increased frequency of ongoing coordination efforts, as necessary, to resolve new and/or immediate concerns.

13. How should the acquisitions or consolidations of water utility systems in disadvantaged communities be approached?

Through the Commission's Environmental and Social Justice plans, ongoing coordination with SWRCB's Human Right to Water Programs, and Cal Advocate's recommendations contained within the section Foundation for An Acquisition Framework, above, acquisitions and consolidations of water utility system can be approached in a manner that identifies and appropriately responds to the needs of disadvantaged communities.

14. What incentives for acquiring inadequately operated and maintained water utility systems should be explored?

In nearly every general rate case of water IOUs, the Commission establishes a capital spending budget less than that proposed by the utility to be just and reasonable. This implies that water IOUs are eager to commit more capital spending than otherwise necessary in order to have a guaranteed profit return included customer rates. Every capital expense reasonably and prudently related to an acquisition will be funded by ratepayers and earn the utility an authorized profit determined by the Commission to be just and reasonable. More importantly, unlike a water IOU's regular and recurring operations, which include the risk of construction delays, budget variance, personal injury

or worse, the acquisition of a water utility system is one of the easiest and least risky methods to increase a water IOU's the rate base on which the water IOU earns its authorized rate of return. Even taking into account the potential for significant system improvements that would be similar to the challenges of sustainably operating their existing water systems, the lump-sum increase to rate base afforded by acquiring a water system outright is an activity warranting no additional incentives than those that currently exist.

In terms of potential seller's incentive, the recommendations contained with Cal Advocate's Section 3: Prevent Windfall Monopoly Profit do provide an incentive within established and reasonable gain on sale rules. However, in this area of creating seller's incentive, the Commission must be careful to avoid rewarding bad actors and behavior. For example, water systems that have been so poorly operated as to necessitate a change in ownership in order to provide safe and reliable service should not produce unexpected windfalls for the owners who have failed to maintain the water system.

15. How should the Commission consider or treat grant funding in water utility system acquisitions?

Because IOUs should not profit from sources of funds not provided by investors, Water IOUs should be required to apply for available alternative fund sources that will mitigate an acquisition's impact on rate payers. Further, requiring water IOUs to disclose their attempts at seeking grant funding for an acquisition would provide the Commission with even more valuable data when determining whether an acquisition is fair and reasonable.

16. What alternatives to acquisitions—for example, the administrator process outlined through Senate Bill (SB) 200—should be considered?

The California SWRCB has a robust, comprehensive, and step-by-step approach to consolidation of water systems that the Commission should consider when evaluating the reasonableness of proposed acquisition applications. Details regarding this program are

located here:
https://www.waterboards.ca.gov/drinking_water/certlic/drinkingwater/consolidation.html.

4.1.4. Issue 4 – Schedule and Timeline

17. What would help expedite the resolution of the Commission's water utility acquisitions?

Cal Advocate's recommendations contained within the section Foundation for an Acquisition Framework, above, are designed to reduce the ambiguity and contentiousness that frequently exists in acquisition proceedings and allow the Commission to expedite resolution.

18. What schedule and framework would achieve the goal of timely resolutions of the acquisitions (proceedings and advice letters) while affording the Commission adequate time for deliberation of the issues scoped in water utility acquisitions?

Cal Advocate's recommendations contained within the section Foundation for An Acquisition Framework, above, are intended to meet or exceed all statutory requirements regarding the resolution of Commission proceedings.

19. What reporting requirements, if any, should be adopted for proposed water utility acquisitions?

Please see the recommendations contained with Cal Advocate's Section 1: Better Data Yields Better Results, and Section 4: Require Transparency in Acquisition Applications, above.

4.1.5. Issue 5 – Legislative Update

20. Should the Commission recommend that the Legislature revisit the Public Water System Investment and Consolidation Act of 1997 and clarify the legislative intent?

The Commission has the existing authority to enact all the recommendations contained within Cal Advocate's section Foundation for An Acquisition Framework, above.

Respectfully submitted,

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