STATE OF CALIFORNIA EDMUND G. BROWN JR., Governor

PUBLIC UTILITIES COMMISSION
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TO PARTIES OF RECORD IN RULEMAKING 11-11-008:

This is the proposed decision of Commissioner Catherine Sandoval. Until and unless the Commission hears the item and votes to approve it, the proposed decision has no legal effect. This item may be heard, at the earliest, at the Commission's June 26, 2014 Business Meeting. To confirm when the item will be heard, please see the Business Meeting agenda, which is posted on the Commission's website 10 days before each Business Meeting.

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

/s/ TIMOTHY J. SULLIVAN
Timothy J. Sullivan,
Chief Administrative Law Judge (Acting)

TJS:dc3

Attachment

COM/CJS/dc3/sbf **PROPOSED DECISION** Agenda ID #13035
Quasi-Legislative

Decision <u>**PROPOSED DECISION OF COMMISSIONER SANDOVAL**</u>
(Mailed 5/27/2014)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion into Addressing the Commission's Water Action Plan Objective of Setting Rates that Balance Investment, Conservation, and Affordability for the Multi-District Water Utilities of: California-American Water Company (U210W), California Water Service Company (U60W), Del Oro Water Company, Inc. (U61W), Golden State Water Company (U133W), and San Gabriel Valley Water Company (U337W).	Rulemaking 11-11-008 (Filed November 10, 2011)

DECISION PROVIDING FURTHER GUIDANCE FOLLOWING RELEASE OF STAFF REPORT

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Attachment A: Report on Balanced Rate Rulemaking

DECISION PROVIDING FURTHER GUIDANCE FOLLOWING RELEASE OF STAFF REPORT

1. Summary

Following workshops, a workshop report by the Commission's Water and Audits Division, and multiple rounds of comments, we provide guidance on rate balancing for Commission-regulated, multi-district water utilities for use in their next general rate case applications. We direct all of these multi-district water utilities to review their own districts for high-cost and/or affordability problems and to report on the review in their next general rate case applications. Where high-cost and/or affordability problems exist, each multi-district water utility must propose one or more intra-utility solutions, which may include a Rate Support Fund or other cross-subsidization mechanism, some form of additional district consolidation, or other relief, as further discussed in this decision. The record, on balance, does not support a single, prescriptive approach or solution.

2. Background

The Commission issued this Order Instituting Rulemaking (OIR) on November 10, 2011 to address a major policy objective in the Water Action Plan as it affects multi-district water utilities.[1] That policy objective, the sixth among the six objectives identified in the plan, is to set rates that balance investment,

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[1] The Water Action Plan serves as a guide in the Commission's regulation of investor-owned water utilities. The original plan, adopted by the Commission in 2005, is available on the Commission's website at this link: ftp://ftp.cpuc.ca.gov/PUC/hottopics/3water/water_action_plan_final_12_27_05.pdf

The current Water Action Plan, adopted on October 28, 2010, updates the 2005 plan and is available at this link: http://docs.cpuc.ca.gov/PUBLISHED/Graphics/125501.PDF conservation, and affordability.[2] The Commission focused this OIR on balancing investment, conservation, and affordability in multi-district water utilities.

To advance the discussion, the OIR posed eight preliminary questions and requested comments from the named respondents (the five Commission-regulated, multi-district water utilities and the Division of Ratepayer Advocates (DRA)) and from any other interested persons and entities.[3] Thereafter, by ruling on April 18, 2012, Administrative Law Judge (ALJ) Gary Weatherford called for prehearing conference (PHC) statements, which parties filed on May 16, 2012. The Commission held a PHC on May 23, 2012 and, as required by Pub. Util. Code §1701.1(b), the assigned Commissioner, Commissioner Sandoval, issued a scoping memo following the PHC.[4]

Based on all of the filed comments and statements as well as the PHC discussion, the scoping memo clarified and slightly revised the OIR's preliminary statement of scope to focus on *intra*-utility policy solutions and to

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[2] The other five objectives are these: (1) maintain highest standards of water quality; (2) strengthen water conservation programs to a level comparable to those of energy utilities; (3) promote water infrastructure investment; (4) assist low income ratepayers; and (5) streamline CPUC regulatory decision-making. (See 2005 Water Action Plan at 4; 2010 Water Action Plan at 4.)

[3] The five multi-district water utilities are: California-American Water Company (Cal-Am); California Water Service Company (CWS); Del Oro Water Company, Inc. (Del Oro); Golden State Water Company; and San Gabriel Water Company. The Division of Ratepayer Advocates (DRA) has since been renamed the Office of Ratepayer Advocates.

The following parties filed initial comments on March 1, 2012: all respondents, as well as the Natural Resources Defense Council and The Utility Reform Network (TURN). On March 22, 2012, the following parties filed reply comments: all respondents except Del Oro, TURN and Jeffrey Young, a CWS ratepayer.

[4] *Assigned Commissioner's Scoping Memo and Ruling*, filed June 20, 2012.

exclude consideration of *inter*-utility transfers or other *inter*-utility adjustments. The scoping memo recognized that any thoughtful, fair discussion of new, inter-utility rate balancing mechanisms should not be limited solely to the respondent multi-district water utilities, but also should include Commission-regulated single-district utilities. Thus, the scoping memo expressly excluded inter-utility mechanisms from consideration in this rulemaking, as follows:

> The scope of this rulemaking is to consider adopting new or revised guidelines for consolidation of districts, some variation of a high cost fund within multi-district utilities, and another mechanism or a combination of them as a means to advance the Commission's water action plan objective of setting rates that balance investment, conservation, and affordability. Inter-company mechanisms will not be explored in this proceeding. Any consideration of mechanisms in addition to consolidation guidelines and a High Cost variant will be informed and bounded by the analysis in this proceeding's workshops, data requests and responses, comments and reply comments, and other information submitted in the record of this proceeding. (Scoping Memo at 3-4, *emphasis* added.)

The scoping memo also set two workshops, required preparation of a draft workshop report, and provided for comments on the draft report, followed by release of a final workshop report. Though the scoping memo's initial schedule was revised, the Commission followed this procedural plan and held two workshops in 2012, on July 17-18 and on November 6-7. Thereafter, the parties requested additional scheduling adjustments and as they requested, ALJ Weatherford, by ruling filed November 14, 2012, authorized comments on materials discussed at the second workshop. Those comments were filed on December 12, 2012.

On July 12, 2013 the Commission's Division of Water and Audits released a draft report titled Report on Balanced Rate Rulemaking (R.) 11-11-008) and served it on the OIR service list. On August 7, 2013, by ruling of the Chief ALJ, ALJ Jean Vieth was co-assigned with ALJ Weatherford. At the request of several parties, the Commission extended the period for comments on the draft staff report; accordingly, comments were filed on August 23, 2013 and reply comments on September 13, 2013. On October 7, 2013 the assigned Commissioner filed an amended scoping memo to confirm various administrative matters and to update the procedural schedule, given the prior, incremental revisions to it. On February 12, 2014, the final version of the staff report, dated January 30, 2014, was served on the service list for this rulemaking and posted on the Commission's website.[5] The final version extensively revised the earlier draft. We refer to the final version as the staff report and append it to this decision as Attachment A.

3. Issues Before the Commission

The staff report identifies and discusses two broad issues where Commission guidance via today's decision will shape future General Rate Case (GRC) applications or Tier 3 Advice Letter (AL) filings by multi-district water utilities.[6] The first issue concerns options for mitigating bills in high-cost districts, either by establishment of an intra-utility Rate Support Fund (RSF) or alternatively, by further consolidation of districts. The second issue focuses on

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[5] The staff report is available at this link: http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M088/K240/88240939.PDF

[6] Del Oro files district-specific, Tier 3 AL GRCs; the other utility respondents file GRC applications.

the existing consolidation guidelines and asks whether they should be revised, and if so, how.

4. Discussion

Today's decision provides policy guidance, on an intra-utility basis, for use by multi-district water utilities as they plan future general rate case applications or Tier 3 AL filings. The OIR has shaped our inquiry, both as to subject and process, by providing:

> As part of advancing the sixth objective in the Water Action Plan, the Commission will consider mechanisms such as a "High-Cost" fund or consolidating districts and rates within the multi-district water utilities. In this proceeding, the Commission will consider these mechanisms on a general policy basis and will not consider the application of the mechanisms to a specific multidistrict utility. To the extent this Rulemaking results in the adoption of new mechanisms, utilities can include requests to utilize these mechanisms in their respective general rate cases or other appropriate rate-setting applications. (OIR at 4.)

However, as the assigned Commissioner's scoping memo determined, due process and fundamental fairness necessarily limit the scope of this rulemaking to intra-utility mechanisms that respondent multi-district water utilities might employ to achieve balanced rates.

Pages 5 through 7 of the OIR recount the Commission's long history of setting rates for water utilities in what has become a standard, case-by-case, locale-by-locale manner, though there are exceptions as well. The traditional approach is attributable largely to the significant variability in supply and distribution costs for different water utilities and for different districts within multi-district water utilities (based on the different costs linked to local or imported water sources, water quality protection and contamination remediation, infrastructure needs, etc.). This cost variability among water utilities contrasts markedly to the comparative uniformity across electric utilities, which operate with statewide "postage stamp" rates.

Thus, the OIR described this rulemaking's approach as a broad, non-exclusive review:

> With the Commission's adoption of its 2010 Water Action Plan, and in light of the Commission's continuing efforts to set rates that balance investment, conservation, and affordability we institute this Rulemaking to consider modifying the 1992 guidelines or establishing new consolidation guidelines for high cost areas for the multi-district water utilities. The Rulemaking will also consider a "High-Cost" fund mechanism. (OIR at 7.)

The record for this rulemaking consists of all the filings, including the parties' written comments, as well as the workshop discussions. Because the attached staff report provides an overview of the comments and the workshop discussions, we do not duplicate that effort here. The record persuades us that the district-specific conditions within each multi–district water utility remain too variable for prescriptive guidelines on an RSF or other cross–subsidy mechanism. Moreover, the record does not compel a choice between authorizing cross-subsidy mechanisms within multi–district water utilities and authorizing further consolidation.

For example, CWS's successful experience demonstrates that an RSF is a tool that should be considered where the particular circumstances in one or more districts within a multi-district water utility warrant rate balancing efforts. Similarly, other cross–subsidy mechanisms can be useful. The record continues to support consolidation, in various forms, as well, but does not persuade us there is need to develop a prescriptive revision of the guidelines developed in

1992 by the then-DRA and the Class A water utilities, titled, "*1992 Guidelines for Combining Water Utility Districts for Ratemaking and Public Utilities Commission Reporting Purposes*." Though the Commission has never formally adopted these guidelines, the parties have relied upon them a number of times to support or oppose proposed district consolidations and the Commission has recognized their value.[7] The 1992 guidelines identify four criteria for consideration in district rate consolidations -- proximity, rate comparability, water supply and operation; the proponents agreed that no districts would be combined for the express purpose of having one district subsidize another.

Based on the record established here, we do not adopt additional prescriptions for rate balancing within multi-district water utilities. However, we conclude that each multi-district water utility should assess, before filing its next GRC application or any district-specific Tier 3 ALs, whether an RSF or further consolidation of its districts will yield rates that more effectively balance investment, conservation and affordability. The record supports use of the following approach. First, each multi-district utility should review all of its separate ratesetting districts to determine whether high-cost and/or affordability problems exist. (One tool available for making such a determination is the high cost and affordability screening framework found at Appendix A of the staff report). Then, if high-cost and/or affordability problems exist in one or more districts, the multi-district water utility should propose a solution or solutions,

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[7] *See* for example: Decision (D.) 05-09-004 [denying CalAm's request to consolidate rates for its Monterey and Felton districts]; D.08-05-018 [denying CalAm's request to consolidate rates for its Larkfield and Sacramento districts]; and D.10-12-017, as modified in other respects by D.11-08-010 [approving merger of CWS's South San Francisco and Mid-Peninsula Districts].

together with a specific implementation plan, in its next GRC application or in appropriate district-based Tier 3 ALs. At a minimum, each multi-district water utility should report on its district-specific review in its next GRC application or in its Tier 3 ALs. The report should be included in the application tendered as a notice of intent under the process and schedule required by the rate case plan.[8]

Proposals for rate balancing, based on identified high-cost and/or affordability problems, may include one or more of the following strategies but need not be limited to them:

1. an RSF or similar cross–subsidy fund;
2. reduction in high costs (see the staff report [Attachment A] and particularly, the decision tree for the high-cost track in Appendix A to the staff report);
3. consolidation in some form, such as:
    a. rate consolidation;
    b. cost consolidation;
    c. rate base consolidation; and
    d. operational consolidation.
4. intra-company grant/loan funding;
5. rate design (affordability through the first rate tier); and
6. budget plans.

This approach is consistent with the recommendations in the staff report, which does not urge a single approach. Rather, the staff report observes that the record for this rulemaking, though it shows no unanimity among parties, does support several, non-exclusive options. The staff report states:

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[8] *See* D.07-05-062, which revised the Rate Case Plan for Class A water utilities approved by D.04-06-018.

> [T]he commission may wish to consider one or more of the following options for the establishment of a rate support fund (RSF); (1) Authorize multi-district water utilities to propose a RSF mechanism for their districts; (2) Establish prescriptive guidelines for the RSF with regards to affordability, usage and subsidy type; and (3) Do not authorize any future RSF mechanisms, and instead, encourage district consolidation as a means to mitigate bills and high–cost districts. (Report on Balanced Rate Rulemaking (R.11-11-008), January 30, 2014 at 2.)

5. Conclusion

We find no single solution should be adopted to mitigate all high-cost and/or affordability problems found to exist within one or more districts of a multi-district water utility. Rather, an appropriate solution may incorporate establishment of an intra-utility RSF or some variation, or additional, district-based consolidation. Each multi-district water utility should perform a district-based rate review, report on the review in its next GRC application or in Tier 3 ALs (as applicable) and propose one or more, appropriate rate balancing solutions to mitigate any high-cost or affordability problems. The report should be included in the application tendered at the notice of intent stage under the rate case plan or as part of the Tier 3 ALs.

6. Next Steps

This proceeding also raised several issues regarding affordability and rates that were not contemplated in the original scope but which are fundamentally related to balanced rates. It is appropriate for the Commission to address these issues presently, especially in light of Governor Brown's January 2014 drought declaration. The Commission will either open Phase II of this proceeding or open a new OIR to analyze and propose actions on issues regarding affordability and rate design, including but not limited to conservation rate design such as tiered rate structures, and accounting mechanisms such as Water Revenue Adjustment Mechanisms. A scoping memo regarding these next steps, or a new OIR, will issue shortly.

7. Comments on Proposed Decision

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

8. Assignment of Proceeding

Catherine J.K. Sandoval is the assigned Commissioner and Gary Weatherford and Jean Vieth are the co-assigned ALJs in this proceeding.

Findings of Fact

1. Supply and distribution costs for different water utilities and for different districts within multi-district water utilities vary significantly, based on the different costs linked to local or imported water sources, water quality protection and contamination remediation, infrastructure needs, etc. This cost variability among water utilities contrasts markedly to the comparative uniformity across electric utilities, which operate with statewide "postage stamp" rates.

2. District-specific conditions within each multi–district water utility remain too variable for prescriptive guidelines on a Rate Support Fund or other cross-subsidy mechanism.

3. The record does not compel a choice between authorizing cross–subsidy mechanisms within multi–district water utilities and authorizing further consolidation of districts.

4. At this time there is no need to develop a prescriptive revision of the guidelines developed in 1992 by the then-DRA and the Class A water utilities, titled, "*1992 Guidelines for Combining Water Utility Districts for Ratemaking and Public Utilities Commission Reporting Purposes*."

5. Each multi-district water utility should perform a district-based rate review, report on the review in the GRC application it tenders at the notice of intent stage or in its district-specific Tier 3 ALs, and propose any rate balancing solution or solutions there.

6. Rate balancing solution(s) to mitigate high-cost and/or affordability problems may include any of those discussed in the body of this decision and identified in the Ordering Paragraphs, but need not be limited to them.

Conclusions of Law

1. Fundamental fairness and due process limit the scope of this rulemaking to intra-utility rate balancing mechanisms.

2. Any unresolved requests or motions filed in this rulemaking should be denied.

3. This decision should be effective today to provide timely notice to respondent multi-district water utilities in advance of their next general rate case filings.

O R D E R

IT IS ORDERED that:

1. Prior to the next general rate case applications or Tier 3 Advice Letter filings by each respondent (other than the Office of Ratepayer Advocates), the respondent shall perform a district-based rate review to assess whether high-cost

and/or affordability problems exist in any of its districts. One tool available for determining whether high-cost and/or affordability problems exist is the high-cost and affordability screening framework found at Appendix A of the Report on Balanced Rate Rulemaking (Rulemaking 11-11-008), dated January 30, 2014, by the Division of Water and Audits and appended to this decision as Attachment A.

2. In its next general rate case application or in each district-specific Tier 3 Advice Letter filing (as applicable), each respondent to this rulemaking (other than the Office of Ratepayer Advocates) must report on the review required by Ordering Paragraph No. 1. If the review determines that high-cost and/or affordability problems exist in one or more districts, the general rate case application or Tier 3 Advice Letters also must propose one or more solutions to mitigate those problems, as further specified in Ordering Paragraph No. 3.

3. The proposed solution(s) referenced in Ordering Paragraph No. 2 may include the following but need not be limited to them:

a. a Rate Support Fund or similar cross–subsidy fund;

b. reduction in high costs;

c. consolidation in some form (i.e., rate consolidation, cost consolidation, rate base consolidation, operational consolidation);

d. intra-utility grant/loan funding;

e. rate design (affordability through the first rate tier); and

f. budget plans.

4. Any unresolved requests or motions filed in this rulemaking are denied.

This order is effective today.

Dated ____________________________, at San Francisco, California.

ATTACHMENT A

Report on Balanced Rate Rulemaking

(R.11-11-008)

California Public Utilities Commission

Division of Water and Audits

January 30, 2014

Executive Summary

This report presents the Division of Water and Audits (DWA) evaluation and recommendations in Order Instituting Rulemaking (OIR) R.11-11-008—a proceeding to address the Water Action Plan's (WAP) sixth policy objective of setting rates that balance investment, conservation, and affordability for multi-district water utilities. The rulemaking's scope was to consider adopting new or revised guidelines for consolidation of districts, some variation of a high cost fund within multi-district utilities, and another mechanism or a combination of them as a means to advance the Commission's WAP objectives. Inter-company mechanisms were specifically excluded from the rulemaking.

The OIR invited the participants to file initial and reply comments to a series of questions regarding consolidation and high cost funds, four days of workshops were conducted, and a DWA developed High Cost / Affordability Framework was discussed. Twelve parties participated in the OIR.

DWA presented a draft staff report on July 12, 2013. Comments and Reply Comments were filed in response to the draft report. In response to comments, the report has been extensively revised. The report is now focused on the OIR's scope as defined in the Assigned Commissioner's Scoping Memo and Ruling dated June 21, 2012. This report does not attempt to capture every comment made by the parties in several rounds of comments and replies, and at the four days of workshops. The report now presents actionable options that the Commission may pursue in the resolution of this rulemaking. These options are based upon the vigorous workshop discussions and extensive comments filed in this proceeding. While parties have also requested that an all-party meeting with the Administrative Law Judge (ALJ) be convened before issuance of the final DWA report, such a meeting is not be needed given the extensive revisions to the report.

The report finds that the Commission has many viable and actionable options with regard to a high cost fund and to district consolidation. Based on our discussion with the parties and a review of their comments, the Commission may wish to consider one or more of the following options for the establishment of a Rate Support Fund (RSF); (1) Authorize multi-district water utilities to propose a RSF mechanism for their districts; (2) Establish prescriptive guidelines for the RSF with regards to affordability, usage and subsidy type, and (3) Do not authorize any future RSF mechanisms, and instead, encourage district consolidation as a means to mitigate bills in high-cost districts.

The Commission may wish to consider one or more of the following options for the establishment of revised consolidation guidelines; (1) Retain the existing guidelines and continue evaluating consolidation requests on a case-by-case basis; (2) Eliminate the guidelines in their entirety and signal that the Commission is open to consolidation requests that balance investment, conservation and affordability; (3) Revise the guidelines to better reflect the adoption of new technology and of new regulatory goals to balance investment, conservation and affordability; y; and (4) Expand the existing guidelines to take into account additional factors such as the condition of infrastructure, the ability of customers to pay additional costs of improvements, and whether consolidation will improve the possibility of securing state and federal grants for improvements.

Rulemaking

On November 10, 2011, the Commission adopted Order Instituting Rulemaking (OIR) R.11-11-008, to initiate a proceeding to address the Commission's Water Action Plan's (WAP) sixth policy objective of setting rates that balance investment, conservation, and affordability for multi-district water utilities. The WAP[1] identified six actions for consideration as possible

[1] California Public Utilities Commission December 15, 2005 Water Action Plan, p. 20 and 21, the principles and objectives of which remain the same in its updated 2010 Water Action Plan, p. 7.

means to advance this objective, several of which have been examined in other proceedings, including the multi-district water utilities' general rate cases.

The OIR states in part:

> "By initiating this OIR, we focus on this sixth objective of setting rates that balance investment, conservation, and affordability, with a focus on multi-district water utilities. We recognize that, while a core principle of establishing rates is to maintain rates that are "just and reasonable," the application of this core principle (and the sixth objective of the Water Action Plan) can be challenging.
>
> Among the actions listed to advance this objective is to consider the development of policies to subsidize high cost areas, either through some variation of a "High-Cost" fund or through consolidation of districts and rates…
>
> As part of advancing the sixth objective in the Water Action Plan, the Commission will consider mechanisms such as a "High-Cost" fund or consolidating districts and rates within the multi-district water utilities. In this proceeding, the Commission will consider these mechanisms on a general policy basis and will not consider the application of the mechanisms to a specific multi-district utility. To the extent this Rulemaking results in the adoption of new mechanisms, utilities can include requests to utilize these mechanisms in their respective general rate cases or other appropriate rate-setting applications."

The OIR's Preliminary Scoping Memo states in part "The scope of this rulemaking is to consider establishing new guidelines for consolidation of districts or for some variation of a "High-Cost" fund, within the multi-district water utilities, as a means to advance the Commission's Water Action Plan's objective of setting rates that balance investment, conservation, and affordability." In addition, the OIR invited the participants to file initial and reply comments to the following eight questions; (Twelve parties participated in the OIR.[2])

Question 1 – Identify current mechanisms utilized to subsidize rates and prevent rate shock, such as low-income rates and rate support funds. Are these current mechanisms adequate to address ratepayer needs in general? Do these current mechanisms achieve an appropriate balance between utility investments, conservation and affordability of rates?

Question 2 – Should the Commission modify the existing 1992 consolidation guidelines, as described in D.05-09-004? If so, what specific modifications are warranted and what are the justifications for those modifications?

Question 3 – To the extent a new district consolidation mechanism is necessary, identify and discuss significant characteristics of water districts that should be included in an analysis of whether consolidation is appropriate. Examples of significant characteristics include: infrastructure, geography, topology, hydrology, climate, water quality, nature of water supply, rate differences and average water usage.

Question 4 – What advantages and disadvantages, if any, would result from implementing a "High-Cost" fund? How could such a "High-Cost" fund operate?

Question 5 - What requirements and conditions, if any, should be included in any new district consolidation mechanism or "High-Cost" fund?

Question 6 - What impacts would increase consolidation of water utility districts or the establishment of a "High-Cost" fund have on: (A) land development in the districts and (B) ongoing water and energy conservation efforts, including those

[2] Named participants include five multi-District utilities (California-American Water Company, California Water Service Company, Del Oro Water Company, Inc., Golden State Water Company, and San Gabriel Valley Water Company) and The Division of Ratepayer Advocates. Other interested parties are The Utility Reform Network (TURN), The National Consumer Law Center (NCLC), Natural Resources Defense Council, City of Visalia, County of Lake, and Jeffrey Young (a ratepayer).

> mandated by Federal and State laws such as the Water Conservation Act of 2009? Is it possible to effectively mitigate these impacts?
>
> Question 7 – What impact, if any, would Public Utilities Code Section 701.10 or other statutory requirements have on the ability of multi-district water utilities to establish a "High-Cost" fund or to increase consolidation?
>
> Question 8 – Identify any additional impacts that would result from increased consolidation of water utility districts or the establishment of a "High-Cost" fund.

After opening comments and reply comments were filed, a Prehearing Conference (PHC) was held on May 27, 2012. Following the PHC, the assigned Commissioner issued a Scoping Memo and Ruling, dated June 20, 2012, which replaced the provisional Preliminary Scoping Memo in the previous paragraph with the following:

> The scope of this rulemaking is to consider adopting new or revised guidelines for consolidation of districts, some variation of a high cost fund within multi-district utilities, and another mechanism or a combination of them as a means to advance the Commission's water action plan objective of setting rates that balance investment, conservation, and affordability. *Inter-company mechanisms will not be explored in this proceeding (emphasis added)*. Any consideration of mechanisms in addition to consolidation guidelines and a High Cost variant will be informed and bounded by the analysis in this proceeding's workshops, data requests and responses, comments and reply comments, and other information submitted in the record of this proceeding."

The assigned Commissioner stated in her Scoping Memo and Ruling that this change was made because "Fruitful discussion during the PHC has convinced me that mechanisms for achieving the balanced rates objective of this rulemaking may not be mutually exclusive, may not be limited to consolidation guidelines and a High Cost Fund variant, and that intra-company mechanisms alone should be considered."

The Scoping Memo established a schedule for completion and included an opportunity for two workshops.

Workshops were convened by DWA Staff (Staff) on July 17-18, 2012, and again on November 6-7, 2012. During the first workshop, participants discussed Definitions of key terms, existing support mechanisms in the communications and water industries, guidelines that are currently used by the Commission in evaluating utility consolidations, the Commission's experiences in past consolidations, and additional factors that the Commission should consider when reviewing consolidation of districts of multi-district utilities. In the second workshop, participants discussed the principles that should govern consolidation of utility districts and an "Integrative Framework" proposal submitted by Staff to identify high cost districts in multi-district utilities, and considerations for a High Cost Fund for the water industry.

A two-track high cost and affordability integrative framework /decision tree was developed to provide a visual tool to evaluate high cost drivers and district conditions and to identify districts with potential high-cost and/or affordability issues. The high cost track identifies high-cost districts within a multi-district utility that have potential affordability issues. The affordability track identifies if utility customers in a district have affordability related issues that need remediation. The purpose of the Framework was to foster a discussion among the parties to address the scope of the rulemaking. No consensus was reached regarding the use of the Framework as a generic mechanism to be used by the water utilities for use in district consolidation.

The Framework is attached as Appendix A.

High Cost Fund within Multi-District Utilities

1. Telecommunications High Cost Funds

The workshop discussion of the issue of adopting a variation of a high-cost fund within multi-district utilities began with an overview presentation on the telecommunication industry's High Cost A and B Funds by the Commission's Communications Division. The High Cost Fund B provides a subsidy to identified-high cost service areas equal to the difference between a Commission-established cost benchmark for what is recoverable from a customer and the actual cost of serving the customer. Communication Division staff indicated that a B Fund model could be applicable to the multi-district water utilities if the Commission can: 1) identify the specific areas that are high cost and 2) establish a cost benchmark. The B Fund the benchmark was set at an average cost based on a state-wide cost study designed by the utilities.

Communications Division staff noted that high cost funds can affect various incentive mechanisms in the regulatory process. These funding mechanisms de-couple in the customer's mind the link between costs and rates in these high-cost areas. This can act to mute customer concerns and protests over increasing costs of providing service to these areas and thereby removes an important check on the utilities' requests for increased costs. The result noted by Communications Division staff is that high cost funds can incentivize utilities to over invest and for the Commission to more readily pass through revenue requirement increases than would be the case absent a high cost fund.

2. Water Industry High Cost Fund

California Water Service Company (Cal Water) presented an overview of its Rate Support Fund (RSF) that the Commission has authorized for three of its high-cost districts (Kern River Valley, Redwood Valley, and the Fremont Valley service area in Antelope Valley). Cal Water noted that these districts are all small systems with high rates, many low-income customers, immediate infrastructure needs for water quality or supply, and affordability concerns. Cal Water indicated that the starting point for the RSF was a rate base equalization account where

Cal Water would cap rate base per customer in these high-cost districts at Cal Water's system-average rate base.

Cal Water and the then Division of Ratepayer Advocates (now Office of Ratepayer Advocates (ORA)) crafted a joint agreement addressing ORA's concerns with Cal Water's rate base equalization proposal. The RSF contains a general support component for all customers in the identified high-cost districts.[3] The current rate support is provided either in a monthly credit per service connection that ranges from $12.10 to $25.00 per month or through a volumetric credit per hundred cubic feet (Ccf) of $10.37 and $2.31 in the Coast Springs and Redwood Unified tariff areas, respectively, in the Redwood Valley District. These credits are funded through a quantity surcharge of $0.01 per Ccf applicable to all metered customers except those participating in the Low-Income Ratepayer Assistance program.[4]

ORA and Cal Water examined a number of factors beyond the cost of water in identifying impacted high cost districts. ORA in its presentation identified affordability which it characterized generally as a function of customer income, customer usage, and cost of service as important factors to be jointly considered in identifying districts eligible for RSF assistance. This is generally echoed by Cal Water in its discussion of the lessons learned in designing and developing the RSF. In addition, Cal Water indicates an RSF mechanism will only work for a water system where the subsidy is large enough to be meaningful, but the cost to non-participating customers is low enough to not have them in opposition. Cal Water has the advantage of having 450,000 other customers supporting 7,000 customers in the RSF districts.

ORA raised several cautionary concerns when considering establishment and design of any sort of high cost fund, including: 1) the need for rate relief should be established where the program is not just subsidizing an area because it is high cost; 2) the subsidy should be granted

[3] In the case of the Antelope Valley District, only customers in the Fremont Valley service area are subject to the support component in the RSF.

[4] Analogous surcharges are applied monthly to flat-rate customers with the exception of customers in the Low-Income Ratepayer Assistance program.

short term to be reviewed and the need re-established in each subsequent general rate case; 3) the subsidies should not result in low income customers subsidizing high income or high usage customers; and 4) sustainable and efficient uses of water should always be encouraged.

3. High Cost Fund Issues and Parameters

During the course of the workshops parties discussed a number of issues and parameters surrounding the design and implementation of an intra-utility high cost fund for multi-district utilities along the lines of the RSF program developed by Cal Water and ORA. The following questions are identified in the workshop as needing to be addressed as part of the design and development of a RSF program.

3.1 Should the RSF Program Be Extended to Other Multi-District Utilities?

The Joint Consumers[5] believe a program modeled after the RSF should be part of the Commission's regulatory options. (Joint Consumers Comments at p. 16) Cal-Am supports the limited use of an RSF where the Commission determines that a very high percentage of customers have affordability issues in paying their water bills and other measures, such as rate consolidation, are not warranted. (Cal-Am Comments at p.6). The City of Visalia does not support expansion of the RSF program in its current form as the existing program is subsidizing non-low-income customers that may not have affordability issues. Any expansion of the RSF program should be revised to ensure subsidy benefits are available to only qualified low-income customers. (Visalia Comments at p. 6) A number of participants also raise concerns about "payment-troubled" (LIRA and non-LIRA working poor) customers having to support customers who need no assistance. (Young Comments at p. 3, Joint Consumers Comments at p. 17). Cal Water indicates there is a limited appetite among non-participating customers to continue, much less expand, mechanisms to subsidize other customers with RSF. (Cal Water Reply Comments at p. 3). San Gabriel emphasizes that before mandating any utility to expend time and resources in examining the application of an RSF program, the

[5] National Consumer Law Center and The Utility Reform Network

Commission consider the utility-specific circumstances. (San Gabriel Comments at p. 8). During Cal Water's workshop presentation, it cautions that the design and implementation of its RSF program is such that its applicability may be of limited use for other multi-district utilities. The idea that not all multi-district water utilities are similarly situated when it comes to the applicability of an RSF program is reiterated by San Gabriel. (San Gabriel Comments at p. 2).

3.2 Should the Commission Mandate Prescriptive RSF Guidelines?

Cal-Am states that the Commission should avoid mandating prescriptive guidelines and mechanisms given the varying differences in the issues facing each multi-district utility. (Cal-Am Comments at pp. 2-3). ORA, Cal Water, San Gabriel all agree that guidelines or guidance be kept relatively flexible to allow parties to tailor any program to the particular utility circumstances. TURN, however, would like the guidelines and guidance coming out of this Rulemaking to be fairly specific. Mr. Young argues that the criteria used in the past are subjective and suggests it may be better for the Commission to set out an objective set of criteria in advance to be used in general rate cases. The general consensus among workshop participants is that a utility's general rate case is the best venue for reviewing these matters as it allows parties and ultimately the Commission to review various regulatory mechanisms to address high cost and customer affordability as a package.

3.3 What Is an Appropriate Affordability Criterion for an RSF Program?

There are two explicit affordability criteria mentioned during the workshops. First, a recommendation by the California Department of Public Health that if a monthly water bill exceeds 2.5% of monthly median household income (used in the Framework), a customer's water service is not affordable. The U.S. Environmental Protection Agency's recommended figure for this metric is 1.5%. Mr. Young and the Joint Consumers support the lower 1.5% figure if an affordability criterion is included in any guidelines. (Young Comments at p. 2, Joint Consumers Reply Comments at p.9). However, the Joint Consumers raise concerns that using median household income may not be sufficiently granular to accurately capture the affordability condition in each utility district. (Joint Consumers Reply Comments at p. 10)

3.4 What is an Appropriate Usage Criterion for Determining Affordability?

There is general consensus that any affordability criterion should be based on essential levels of indoor water use. It was argued that use of the average water bill to determine affordability could lead to subsidies to reduce the cost for outdoor water use. (NRDC Comments at p. 3). NRDC, Cal Water, and Joint Consumers all indicate that average winter water consumption is a valid proxy for indoor water use. (NRDC Comments at p. 5, Cal Water Comments at 3, Joint Consumers Comments at p. 13). However, there was no final recommendation on what this figure should be. ORA in its workshop presentation and Cal Water suggest looking at a usage criterion for affordability of 10 Ccf per month or less. This figure does not account for household size and may be very generous in certain situations and borderline in other areas. A 10 Ccf per month usage correlates to approximately 60 gallons per day per capita for a household of four people.

3.5 What is an Appropriate High Cost Criterion for an RSF Program?

There is general consensus that a high cost district metric should be based on a district's revenue requirement per Ccf of sales. This metric is preferred over the revenue requirement per customer (as contained in the Framework) as it overcomes analysis that may be skewed by differences in size and composition of a utility's customer base or in usage among customer classes. (San Gabriel Comments at p. 4, Golden State Comments at p. 15). San Gabriel cautions that the revenue requirement per Ccf is not without problems when it is applied in districts in vacation areas with a high number of customers but low seasonal usage. Visalia echoes the caution over the use of revenue requirement per Ccf. (Visalia Reply Comments at p.3). San Gabriel recommends both metrics should be considered in applying a high cost threshold. (San Gabriel Comments at p. 5) Cal Water shows that the four tariff areas with the highest revenue requirement per Ccf match the four tariff areas receiving subsidy benefit under the RSF program. (Cal Water Reply Comments at Attachment A).

The second component to the design of a high cost criterion is the threshold that should be used for determining if a district or identified sub-area qualifies as a high-cost area. A figure used in workshop discussions is that a district that has revenue requirement per Ccf that is greater than 150% of the utility average revenue requirement per Ccf qualifies as a high cost district. (Golden State Comments at p. 18). The 150% figure is taken from the threshold that is used for the telecommunications High Cost A Fund. Joint Consumers indicate that the exact figure to be used was not settled, nor was there agreement on what to compare the revenue requirement per ccf figure against to determine what is a high-cost area, utility average or a particular geographic region. (Joint Consumers Comments at p. 14).

3.6 How Should the RSF Subsidy Be Designed?

Cal Water's current RSF program delivers the subsidy benefit either as uniform credit to the monthly service charge (Freemont Valley, Kern River Valley, and Lucerne) or a uniform quantity credit (Coast Springs and Redwood Unified).[6] The Joint Consumers and Visalia urge that an RSF subsidy benefit should vary with income. (Joint Consumers Comments at p. 3, Visalia Reply Comments at p. 3).

In our examination of a high cost fund within multi-district utilities, we requested parties to comment on five questions posed in the OIR, we reviewed the telecommunication industry's high cost funds at our first workshop, and we discussed and received comments on the Rate Support Fund used by Cal Water. A number of themes emerged from our review and discussions. While there was some general consensus, there was less agreement on many of the issues posed in our questions and at our workshops.

[6] In A. 12-07-007, a Settlement Agreement in Cal Water's current general rate case has been filed to amend the subsidy design for the RSF program whereby the RSF quantity rate would be set a 150% of the system-wide quantity rate. The RSF quantity rate would be applicable for the first 10 Ccf of usage (4 Ccf for Coast Springs). All usage above 10 Ccf would be charged at the a full quantity rate for the district or tariff area.

The Cal Water RSF was used as the proxy for discussion of a high cost fund. ORA and Cal Water described at length how the RSF was established and the factors considered in its development. The parties used the RSF program to discuss the design and implementation of intra-utility high cost fund. A number of issues were raised including extension of the RSF to other utilities, whether prescriptive RSF guidelines should be established, affordability and usage criterion to be used, and subsidy designs.

Based on our extensive discussion with the parties and a review of their comments, the Commission may wish to consider the following options for the establishment of an RSF.

Option #1: Authorize multi-district water utilities to propose a RSF mechanism for their districts. Such a proposal should be filed as a part of a general rate case proceeding. Review and evaluate RSF requests on an individual basis. Do not mandate prescriptive guidelines for the RSF with regards to affordability, usage and subsidy type.

Option #2: Establish prescriptive guidelines for the RSF with regards to affordability, usage and subsidy type. Require that future RSF requests meet the established guidelines. For example, the RSF benefit provided could decline with increasing income. An RSF could also exempt low-income customers outside of the RSF area from contributing to the RSF.

Option #3: Do not authorize any future RSF mechanisms. Instead, encourage district consolidation as a means to mitigate bills in high-cost districts.

Consolidation

Water rates for multi-district investor-owned water utilities in California are set and approved by the Commission for each district. Each district is "stand alone", has distinct characteristics and, may or may not be contiguous to other districts in the utility system or be physically interconnected.[7] Each district has a unique revenue requirement and rates that are established through a general rate case every three years. The Commission may permit cross-subsidization between customers when considering consolidation if it determines that such an action is justified. [8] Consolidation in multi-district utilities may be accomplished through: (1) rate consolidation; (2) cost consolidation; (3) rate base consolidation; and (4) operational consolidation.

1.2 Role of the 1992 Consolidation guidelines relative to balanced rates

In 1992, the Division of Ratepayer Advocates and the Class A water utilities jointly developed a set of policy guidelines to be considered in district rate consolidations. These guidelines established four criteria; proximity, rate comparability, water supply and operation, as detailed in D. 05-09-004:

1. "*Proximity*: The districts must be within close proximity to each other. It would not be a requirement that the districts be contiguous as it is recognized that present rate-making districts consist of separate systems which are not connected. It was suggested that districts within 10 miles of each other would meet the location criteria.
2. *Rate Comparability*: Present and projected future rates should be relatively close with rates of one district no more than 25% greater than rates in the other district or districts. To lessen the rate impact of combining districts it may be necessary to phase in the new rates over several years.
3. *Water Supply*: Sources of supply should be similar. If one district is virtually dependent upon purchased water, while another district has its

[7] "Physically interconnected systems" are water systems that are joined by a system of pipes and pumps for transporting water (usually treated water) from one system to another". Source: *EPA/NARUC Report,* Appendix A: Glossary p.74.

[8] Rulemaking at 4 –"In the Water Action Plan, the Commission stated that it would determine whether and when cross-subsidization between customers is justified."

own source of supply, future costs could change by a greater percent for one district versus the other. This could result in significantly different rates in the future even if present rates were quite similar.

4. *Operation*: The districts should be operated in a similar manner. For example, if a single district manager presently operates two or more districts and the billing system is common to the same districts, such an operation would support the combination of the districts."

In D.05-09-004, the Commission stated that the guidelines were intended to set criteria for single tariff pricing that, when met, would establish prima facie reasonableness of the proposed consolidation. The Commission concluded that, while not determinative, the criteria were helpful in evaluating rate consolidation proposals.

During the first workshop, there was extensive discussion of the history, background and experiences with the 1992 Consolidation guidelines. Past consolidation efforts were discussed by DRA, GSWC, Cal-Am and Cal Water. During the workshops, it was pointed out that although the district-by-district rate setting process remains the standard, the Commission has also made exceptions to this approach. For example, in 1994, the Commission approved Golden State Water Company (GSWC)'s request to consolidate its 16 districts into three regions while continuing to keep the ratemaking process at the district level.[9] [10] Similarly, in 2010, the Commission approved the consolidation of California Water Service Company (Cal Water)'s request to consolidate two of its districts into a single new

[9] Region I included water operations located in the central and northern portions of California. Region II included water operations located in or near the South Bay area of Los Angeles County. Region III included water operations located in the mountains and upper desert areas of Southern California, portions of Orange County, and a number of cities in the Inland Empire region of Los Angeles. (Exhibit 1 of GSWC to Investigation 07-01-022).

[10] GSWC states: "the regionalization in 1994 had no effect on the number of ratemaking areas in its system until 1999, when it consolidated its eight ratemaking districts in its Region III into a single region-wide ratemaking area with uniform tariffs. Because of the disparity in the rates of the eight districts in Region III at that time, the Commission adopted a phase-in plan to transition the individual ratemaking areas to regional tariffs. The tariff rates for those districts whose rates were above the regional-wide tariffs were frozen until the region-wide tariffs increased and reached the level of the frozen districts' rates. This consolidation of districts in Region III reduced the number of GSWC's 16 ratemaking areas to nine overriding the 1992 guidelines." See GSWC opening comments on Staff's Draft Report.

district, and establish uniform tariffs for this new district.[11] The Commission again applied the 1992 guidelines in D.08-05-018 when it declined to adopt Cal-Am's request to consolidate its Sacramento and Larkfield districts. [12]

Types of Consolidation

Consolidation in multi-district utilities may be accomplished through: (1) rate consolidation; (2) cost consolidation; (3) rate base consolidation; and (4) operational consolidation.

Rate Consolidation/Single Tariff Pricing

Intra-Utility rate consolidation involves the use of a unified rate structure for multi-district water utility systems that are owned and operated by a single utility. Single tariff pricing aggregates and allocates costs over a broader customer base. Under this system, all customers pay the same tariff rate for service within the district.[13]

Benefits of rate consolidation include spreading fixed infrastructure costs and costs for common functions such as billing and customer service over a larger customer base. These help to stabilize rates and revenues, mitigate rate shock, smooth rate increases and improve affordability especially for small high cost systems. The centralized management and planning functions also help with better planning of investment in water supply infrastructure and more streamlined regulatory, administration and operational activities. The rate and revenue stability may benefit low-income households who can now plan for these expenses and operate under restrictive budgets.

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[11] Decision 10-12-017, at 20. The Commission approved the consolidation of these districts as part of a settlement between the Division of Ratepayer Advocates and California Water Service Company.
[12] D. 08-05-018, at 32.
[13] GSWC stated in its opening comments that "the use of the word "district" is not consistent throughout various Commission proceedings. For example, in 1999 the Commission authorized GSWC to consolidate its eight ratemaking districts in its Region III into a single region-wide ratemaking area with uniform tariffs. GSWC referred to these ratemaking districts as ratemaking areas which fell within three operating districts. In this case all customers pay the same tariff rate for service within the same region covering three operating districts covering eight customer service areas".

A disadvantage of rate consolidation is that it undermines efficient water use and conservation efforts by weakening price signals in high cost areas. By designing the rate structure at the company-wide level rather than at the local level, the connection between the cost of providing service and rates at the local level is weakened. This can partially be overcome through rate design and tiered pricing. The cross-subsidization of customers in high cost areas by customers in lower cost areas breaks the connection between costs and rates and may encourage overinvestment in infrastructure. Growth in high cost areas is encouraged, leading developers and potential residents to fail to take into account the full costs of water, disrupting price signals, imposing subsidy costs on others who live in lower cost areas, and potentially causing costly long-term impacts on water supplies of high cost systems with scarce sources of supply.

Cost Consolidation

Cost consolidation involves the aggregation of selected cost categories across certain service districts for ratemaking purposes. Cost consolidation helps stabilize costs in high cost districts, has less impact on larger districts and does not fully eliminate the traditional "cost-of-service" approach. Parties have commented that a possible disadvantage of cost consolidation is that low-cost areas may subsidize high-cost areas. Concern was expressed that price signals to customers might be impacted, thought to a lesser degree than full consolidation and there may result cost allocation issues.

Rate Base Consolidation

Rate base consolidation refers to the consolidation of the rate base across districts, while leaving in place the expenses for each district. This type of consolidation may alleviate the cost impact resulting from significant increases in plant investment; mitigation of the impact of rate-shock in districts with a low number of service connections and large infrastructure needs; promotion of investment in water infrastructure, and assistance with compliance with water quality regulatory standards. The disadvantages of rate base consolidation include: weakening price signals and conservation efforts; misrepresenting the true cost-of-service, creating cost allocation issues and encouraging over investment in water systems. That said, regulatory oversight can minimize these impacts.

Operational Consolidation

Operational consolidation combines districts on an operational level while retaining a stand-alone revenue requirement for each district for ratemaking purposes. This is an existing characteristic of multi-district utilities. Operational consolidation pools common resources and may result in improved quality of service, cost savings and better access to reliable water supplies. If not properly addressed, disadvantages could include loss of local presence, diminished relationship between the utility and cities /counties with jurisdiction over district areas, and a requirement of separate accounting.

The Rulemaking at p. 7 states "We institute this Rulemaking to consider modifying the 1992 guidelines or establishing new consolidation guidelines for high cost areas for the multi-district water utilities." While some parties prefer that the Commission retain the four guidelines, other parties are open to some modification of the guidelines to reflect the passage of over 20 years and the changes in technology and regulatory mechanisms, including the emphasis of water conservation and more stringent water quality requirements. The parties generally agree that the 1992 guidelines are not dispositive, but instead are guidelines for informing the Commission in making decision on utility applications for consolidation.

San Gabriel is the only water utility that recommends no changes to the guidelines. This is unlike Cal-Am that states "the guidelines are outdated in their entirety and fail to recognize the significant changes to the water industry since these guidelines were first established in

1992." The Joint Consumers[14] indicated that the Commission should supplement its evaluation of consolidations with an evaluation of the following additional information: 1) condition of the infrastructure; 2) the ability of customers in each affected district to pay additional costs of improvements; 3) whether customers in the consolidated and un-consolidated districts will continue to pay just and reasonable rates for appropriate terms of service; 4) whether consolidation will improve the possibility of securing state and federal grants for improvements; 5) the impact of any new debt required for system improvements on customer bills because of consolidation; and 6) whether consolidation will reduce expenses to counteract new debt, 7) technically capable staff, and 8) how customers will react and be impacted.

The 1992 guidelines are used to evaluate consolidation requests, some of which are approved while others are denied. In the absence of updated guidelines, the existing guidelines become a convenient "fall-back" position for utilities, parties and the Commission alike. This rulemaking was established to specifically examine whether modifications and/or new guidelines are warranted in today's environment. At the time the guidelines were established, the water utility business was more "hands-on" in nature and technology solutions that we take for granted today; such as remote meter reading, remote monitoring of water tank levels / pump operations, cell phones, broadband connections, etc., mostly did not exist in utility operations. Several parties generally agree that the Proximity guideline is "less relevant than the other criteria[15]," and DRA has suggested that the Proximity and rate Comparability criteria may not be "hard and fast indicators."[16] The City of Visalia prefers that the guidelines be retained as is.

Similarly, the Operation guideline states that the districts "should be operated in a similar manner," and gives an example of two or more districts operated by the same manager with a

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[14] Joint Consumers comments at P.19
[15] Joint Consumers at P. 22
[16] DRA Comments at P. 15

common billing system. Like the Proximity guideline, this guideline is not as critical as it once was with availability of technology.

The Rate Comparability guideline requires that district rates be within 25% of each other and it recommends the phasing in of rates when possible. Strictly applied, this guideline may result in unintended consequences such as precluding the consolidation of a high cost area with a lower cost area, even if the high cost area was low-income. Cal-Am states that the 25% threshold figure will preclude any further consolidation among its districts[17].

The Water Supply guideline requires that water supply sources should be similar. The concern is that if two districts are combined and one purchases water from a wholesale agency and another pumps water from a non-adjudicated basin, the water supply costs will potentially differ greatly and an inequity will arise. NRDC especially supports the retention of the Water Supply guideline as water costs have a "substantial bearing on current and future rates."

Based on our extensive discussion with the parties and a review of their comments the 1992 consolidation guidelines are ripe for revision. The Commission may wish to consider one or more of the following options for the establishment of revised guidelines:

Option #1: Retain the existing guidelines and continue evaluating consolidation requests on a case-by-case basis. This option retains the status quo.
Option #2: Eliminate the guidelines in their entirety and signal that the Commission is open to consolidation requests that balance investment, conservation and affordability.
Option #3: Revise the guidelines to better reflect the adoption of new technology and of new regulatory goals to balance investment, conservation and affordability. For example, one or more of the guidelines, such as the Proximity / Rate Comparability /

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[17] Cal-Am comments at P. 4

Operation guidelines, could be struck and consolidation requests could be weighed against the remaining guidelines.

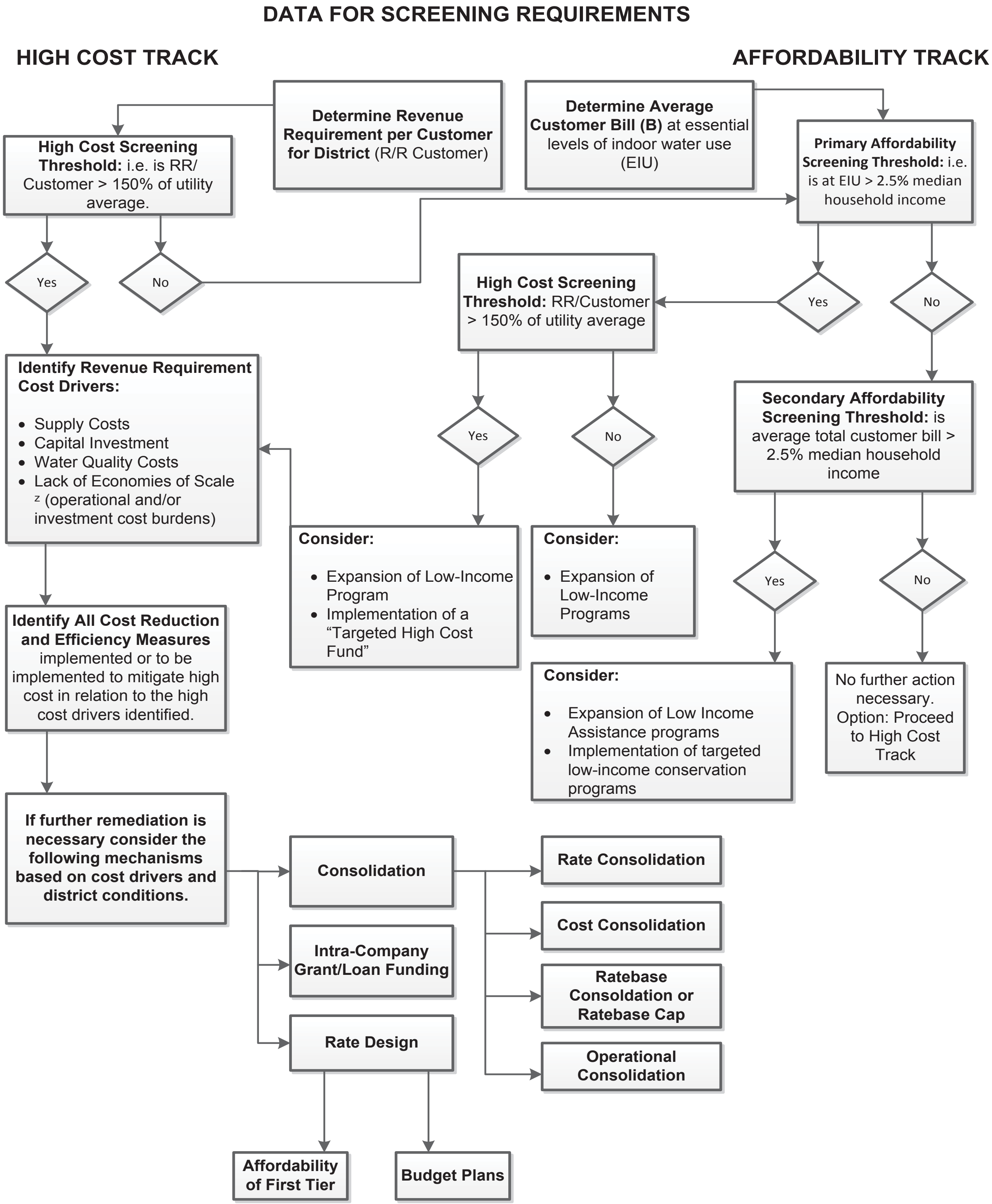
Option #4: Expand the existing guidelines to take into account additional factors. For example, the condition of the infrastructure, the ability of customers in each affected district to pay additional costs of improvements, or whether consolidation will improve the possibility of securing state and federal grants for improvements.

Appendix A

High Cost and Affordability Screening Framework

The purpose of the high-cost track is to identify high-cost districts in a multi-district utility and determine the remediation options available to provide relief to customers in those districts. To apply the high-cost track filters, the utility determines the revenue requirement per customer and compares it with the average revenue requirement across the utility's entire service territory.

The purpose of the affordability track is to determine if the utility customer is foregoing basic necessities to afford water service and to make a determination regarding the need to expand existing low-income assistance programs.



End of Appendix A