

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



April 10, 2018

Jeffrey T. Linam
Director – Rates & Regulatory
California-American Water Company
4701 Beloit Drive
Sacramento, CA 95838-2434

Dear Mr. Linam,

Enclosed is a copy of the utility's Advice Letter No. 1188, which has been withdrawn per Jeffrey T. Linam's letter dated April 10, 2018.

As a reminder, Advice Letter numbers of withdrawn filings shall not be reused.

Please contact Jim Boothe at 415-703-1748, if you have any questions.

Thank you,

/s/ROBIN BRYANT

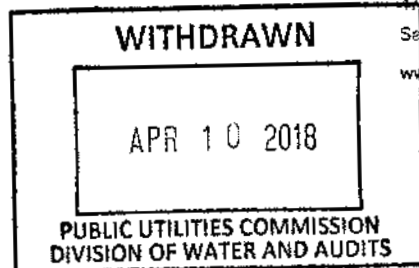
Robin Bryant
Water & Sewer Advisory Branch
Division of Water and Audits

Enclosures

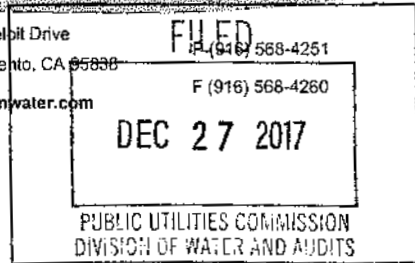


December 27, 2017

ADVICE LETTER NO. 1188



1701 Bellbit Drive
Sacramento, CA 95836
www.amwater.com



TO THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

With a municipal election approving the sale of the City of Bellflower's Municipal Water System's ("Bellflower MWS") assets to California-American Water Company ("California American Water") (U210W) now complete and an asset purchase agreement executed, California American Water will acquire Bellflower MWS's assets. Consistent with D.99-10-064, Appendix D., Section 4.0,¹ California American Water submits this advice letter seeking certain California Public Utilities Commission ("Commission") authorizations (putting in place rates and tariffs, setting rate base, and approving contracts) in connection with California American Water's acquisition of Bellflower MWS's assets.

PURPOSE:

California American Water files this advice letter seeking a Commission Resolution:

- (i) Allowing California American Water to file a Tier 1 Advice Letter placing into effect Bellflower MWS's existing rates with a small additional surcharge as well as other applicable California American Water tariffs, rules, and regulations, following the Close² of the acquisition.
- (ii) Deeming the purchase price paid for the system to be the rate base for ratemaking purposes at the time the acquisition Closes.
- (iii) Incorporating the Bellflower MWS service area into California American Water's Los Angeles County District service area for operational purposes, expanding California American Water's Certificate of Public Convenience and Necessity ("CPCN") to cover the Bellflower MWS area effective at the time the asset sale Closes.
- (iv) Approving the terms and conditions of the agreement transferring assets and water rights from Bellflower MWS to California American Water ("Asset Purchase Agreement"). A copy of the Asset Purchase Agreement is attached as "**Exhibit A.**"
- (v) Approve the terms and conditions of the agreement for transmission and production of water between Bellflower Summerset and California American Water ("Wheeling Agreement"). A copy of the Wheeling Agreement is attached as "**Exhibit B.**"

¹ "In order to facilitate mergers the Commission passed D.99-10-064, October 21, 1999, which established rules for mergers and acquisitions. In accordance with the Settlement Agreement in that decision, an investor-owned that acquires a water system from a municipal corporation is permitted to place into effect rates that are equal to the existing municipal rates or nearby utility rates, or rates lower than either, by filing an advice letter and receiving authorization of the Commission (Appendix D, Section 4.2)." Resolution No. W-4180, *Suburban Water Systems (SWS). Order Approving Modified Rates from those filed by Advice Letter No. 226-W for the area formerly served by West Covina's Water System, and Requiring SWS to file a General Rate Application*, Feb. 3, 2000, at pp. 1-2.

² Capitalized terms have the meaning set forth in the Asset Purchase Agreement entered between California American Water and the City of Bellflower.

After the acquisition's Close, when California American Water takes over the assets and begins service, Bellflower MWS's former customers are expected, until December 31, 2020, to stay on the rates immediately in-place before the acquisition's Close, except for the inclusion of a small surcharge to support Commission operating costs. In California American Water's 2016 General Rate Case, it plans to propose that for the tariffs schedule to go into effect beginning January 1, 2021, Bellflower MWS customers would transition for ratemaking purposes onto California American Water's rates and be subject to the tariff schedules applicable to California American Water's San Marino service area in the Los Angeles County District. This is consistent with the terms and conditions of the asset purchase agreement.

BACKGROUND:

Bellflower MWS serves 1,827 metered customers, approximately 10 percent of the population of the City of Bellflower, from eight separate systems in geographically separated areas. The system serves 1,822 single-family and multi-family residential customers, 1 commercial customer, and 4 industrial customers. The system is located approximately 19 miles from California American Water's Los Angeles County District operations center, which is located in the San Marino service area.

DISCUSSION:

California American Water is purchasing Bellflower MWS's assets. In addition to mains, services, wells, and other utility plant dedicated to utility service, Bellflower MWS holds water rights in the Central Basin. California American Water's purchase of Bellflower MWS's water utility assets as well as expansion of the company's service area to Bellflower MWS's current customers will advance important state goals and help promote access to safe and reliable water service at reasonable rates. Additionally, through the acquisition, California American Water will obtain additional water rights in the Central Basin, which will benefit all customers in California American Water's Los Angeles County District.

A. Acquisition Benefits

California American Water's acquisition of Bellflower MWS's assets offers cost-savings and operational efficiencies associated with California American Water's larger scale of operation.

The acquisition provides tangible customer service, drought mitigation, and emergency response benefits to Bellflower MWS customers. With the acquisition, Bellflower MWS customers will have access to California American Water's low-income programs and online payment options. This includes web self-service for many account services and paperless billing. California American Water's wide-ranging conservation program currently provides rebates for selected water-saving appliances/equipment (e.g., toilets, clothes washers, weather-based irrigation control and efficient sprinkler heads), free water-saving devices such as showerheads and hose nozzles, and free Water-Wise Home and Business Calls, which provide visits by California American Water staff to homes and businesses to review water use and

identify ways to save water. This expanded conservation effort in Bellflower MWS will support Governor Brown's goal to make conservation a way of life for Californians. California American Water's specialized work force is equipped to address the needs of diverse customers with sometimes differing concerns or needs. For example, California American Water can address customers' questions in several different languages.

"It is generally in the public interest for water systems to merge."³ Increases in customers may result in operational efficiencies.⁴ Moreover, the State of California has recognized that small communities, like Bellflower MWS, will likely face difficulty in maintaining adequate water and wastewater systems. In Resolution No. 2008-0048, the California State Water Resources Control Board ("SWRCB") noted that small and/or disadvantaged communities cannot "provide the economies of scale necessary to build and maintain adequate water and wastewater systems." Also, the Commission's own 2010 Water Action Plan specifically supports "incentives for the acquisition or the operation of small water and sewer utilities, in recognition of the benefits to customers of such acquisitions."⁵ Here, California American Water's acquisition of Bellflower MWS's assets and expansion of service to include the area now served by Bellflower MWS will provide recognizable benefits.

There are several key reasons why the public interest is typically served when a smaller utility, like Bellflower MWS, is acquired by a larger utility, such as California American Water. First, larger utilities retain more specialized workforces and have access to newer and more advanced equipment and technology. Second, larger utilities may be able to purchase resources/materials/supplies at lower average prices due to quantity discounts. Additionally, larger utilities benefit from economies of scale, driven by savings related to specialization and by the relationship between the fixed and variable costs of operation. Utilities are capital intensive operations. This means that the fixed costs of providing service are relatively high in comparison to the variable costs. Smaller utilities like Bellflower MWS may find increasing fixed costs to be more burdensome because their customer base is small. Typically, smaller utilities must recover a significant fixed cost from a relatively small number of customers (*i.e.*, the same expenditure could have served more customers), resulting in a relatively large – perhaps burdensome – fixed cost per customer. The acquisition of smaller utilities by larger ones allows fixed costs to be spread over a larger customer base. The benefits of spreading fixed costs continues to grow as regulatory and environmental oversight expands because of the substantial fixed costs associated with specialized labor and equipment related to water quality. The ability of larger utilities (and/or utilities made larger by acquisition(s)) to harness economies of scale typically helps mitigate potential increases in cost per customer to (1) comply with regulatory requirements, (2) maintain customer information and billing systems, (3) purchase adequate materials and supplies, (4) provide high quality customer service, (5) maintain and

³ Resolution No. W-4180, *S uburban Water Systems (SWS). Order Approving Modified Rates from those filed by Advice Letter No. 226-W for the area formerly served by West Covina's Water System, and Requiring SWS to file a General Rate Application*, Feb. 3, 2000, at p. 1.

⁴ *Ibid.*

⁵ 2010 Commission Water Action Plan, p. 9.

improve the quality of treated water, (6) provide reliable access to high quality water supplies, (7) provide for current and future new and replacement infrastructure needs, and (8) support a level of expertise required to navigate the often complex requirements for government sponsored or required programs. Cost savings and consolidations from economies of scale help place downward pressure on the rates – which could help slow rate increases often driven by factors outside the control of the utility.

California American Water is well positioned to realize economies of scale, which would benefit both Bellflower MWS customers and existing customers in California American Water's Los Angeles County District. California American Water serves more than 600,000 people throughout California and has a service territory within commutable distance to Bellflower MWS. California American Water also has the financial resources and operating expertise to improve efficiencies and ensure the system serving Bellflower MWS's current users complies with increasingly stringent state and federal environmental mandates.

Finally, California American Water's ability as a result of the acquisition to obtain additional water rights in Central Basin allows for the additional diversification of California American Water's water resources. These water rights are an especially valuable asset given the limited available water resources in the state. The acquisition of additional water rights benefits all customers in California American Water's Los Angeles County District.

Existing infrastructure of Bellflower MWS's water system, which is currently used for "stand-alone" utility purposes, including, but not limited to wells, tanks, pumping equipment, electrical equipment, and piping, shall remain in service upon the Closing of the sale of the system to California American Water.

The acquisition of Bellflower MWS by California American Water should be approved because it offers real benefits to customers and the proposed rates are reasonable.

B. This Advice Letter Meets All Requirements

Pursuant to Section 5 of General Order No. 96-B, Section 8.1 of the Water Industry Rules in General Order 96-B, and Appendix D to D.99-10-064, California American Water files this advice letter.

California American Water requests such authorization so that immediately after the acquisition, current Bellflower MWS customers will become subject to the tariff's generally applicable for California American Water's San Marino service area customers (with the exception of rates, which for the Bellflower MWS customers will remain the same as they were right before closing, except for the addition of a small surcharge, until 2020), as amended from time to time. Impacts of the transition from Bellflower MWS rates to California American Water rates will not take effect until January 1, 2021.

Under the asset purchase agreement, California American Water will pay \$17,000,000 for the Bellflower MWS's water system assets. Public Utilities Code Section 2720(a) provides that the Commission "shall use the standard of fair market value when establishing the rate base for the distribution system of a public water system acquired by a water [utility]. This standard shall be used for ratesetting." Public Utilities Code Section 2720(a)(2) defines "fair market value" as having the meaning set forth in Code of Civil Procedure Section 1263.320(a), which states that fair market value is "the highest price ... that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for doing, nor obligated to sell, and a buyer, being ready, willing, and able to buy but under no particular necessity for doing so." The Act, therefore, requires that any water corporation acquiring a public water system use the fair market value as the rate base value of the acquired distribution system.

Here, the purchase prices result from arms' length negotiations between a willing and knowledgeable buyer and seller. The sale was also approved by a vote of the community. The total purchase price therefore represents the fair market value for the assets purchased, pursuant to Public Utilities Code Section 2720 and Code of Civil Procedure Section 1263.320(a). D.99-10-064 specifically recognizes that Public Utilities Code Sections 2718-2720 require that any water corporation acquiring a public water system use the fair market value as the rate base value of the acquired distribution system.⁶

The full Purchase Price of \$17,000,000, therefore, shall be recognized as the rate base for the acquired assets. The establishment of \$17,000,000 as the regulated rate base is reasonable as it was determined by fair negotiations between California American Water and Bellflower MWS and is supported by a valuation study. Asset valuations are broken down into i.) infrastructure, ii) real estate, and iii) water rights. Water system assets are the sum of the infrastructure and real estate components. California American Water is also paying \$9,100,000 in fair market value for the rights to Central Basin water based upon the valuation performed. This purchase of prescriptive rights is being accounted for not as a purchase price for the Bellflower MWS, but as a distinct purchase accounted for in the ordinary course of capital investment for the Los Angeles Division. Supporting documents for the purchase price are attached as **Exhibit C**.

Proper notice will be given with respect to the proposed asset sale. The residents of the City of Bellflower approved the sale of the City's water system during the November 2016 election. The Bellflower City Council approved California American Water's contract to purchase the water system on October 23, 2017.

The Agreement between California American Water and Bellflower MWS was executed by the President of California American Water, Richard Svindland, who has authorization to execute such agreements.

Also included is a copy of California American Water's projected financial analysis for an annualized five-year period under California American Water ownership of the Bellflower MWS (**Exhibit D**), which is CONFIDENTIAL pursuant to GO 66-C, Public Utilities Code section 583,

⁶ D.99-10-064, issued Oct. 21, 1999, at p. 2.

and Evidence Code section 1060 because it contains confidential, market sensitive financial information. California American Water is not expected to approach its current Commission authorized return in the five-year period. The estimated impact on California American Water's Los Angeles County District customers is, on average, less than two dollars and twenty five cents per customer per month. However, California American Water customers will not be impacted by the acquisition until January 1, 2021 and the estimated increase is subject to change. The Water Supply Questionnaire is attached as **Exhibit E**.

California Environmental Quality Act (CEQA) review is not required as this advice letter filing involves only the transfer of the existing water facilities and no new construction or changes in the source of water supply are being proposed with the proposed asset sale. Accordingly, approval of this advice letter is not a CEQA project as it is not possible that the transaction will have any significant effect on the environment.

Tier Designation:

Pursuant to General Order No. 96-B, this advice letter is designated as a Tier 3 filing.

Effective Date:

California American Water requests its tariffs for Bellflower MWS customers become effective five days after California American Water files a Tier 1 Advice Letter that provides details of the finalized purchase and tariffs.

Service List:

Pursuant to Section 4.3 of General Order No. 96-B, a copy of this advice letter is being sent to those entities listed in the attached service list. Copies of the detailed workpapers and the documents supporting this Advice Letter have also been furnished to the Commission Staff.

A draft of the notice to be provided to Bellflower MWS customers is attached as **Exhibit F**. A draft of notice to be provided to existing California American Water Los Angeles County District customers is attached as **Exhibit G**. California American Water will work with the Commission's Public Advisors Office, if necessary, to prepare the final notices to be send out to customers.

Protest and Responses:

Anyone may respond to or protest this advice letter. A response supports the filing and may contain information that proves useful to the Commission in evaluating the advice letter.

A protest objects to the advice letter in whole or in part and must set forth the specific grounds on which it is based. These grounds may include the following:

- (1) The utility did not properly serve or give notice of the advice letter;*
- (2) The relief requested in the advice letter would violate statute or Commission order, or is not authorized by statute or Commission order on which the utility relies;*

(3) *The analysis, calculations, or data in the advice letter contain material error or omissions;*

(4) *The relief requested in the advice letter is pending before the Commission in a formal proceeding; or*

(5) *The relief requested in the advice letter requires consideration in a formal hearing, or is otherwise inappropriate for the advice letter process; or*

(6) *The relief requested in the advice letter is unjust, unreasonable, or discriminatory (provided that such a protest may not be made where it would require relitigating a prior order of the Commission.)*

A protest shall provide citations or proofs where available to allow staff to properly consider the protest.

A response or protest must be made in writing or by electronic mail and must be received by the Water Division within 20 days of the date this advice letter is filed. The address for mailing or delivering a response or protest is:

Tariff Unit, Water Division, 3rd floor
 California Public Utilities Commission,
 505 Van Ness Avenue, San Francisco, CA 94102
 water_division@cpuc.ca.gov

On the same date the response or protest is submitted to the Water Division, the respondent or protestant shall send a copy by mail (or e-mail) to us, addressed to:

Recipients:	E-Mail:	Mailing Address:
CA Rates	ca.rates@amwater.com	4701 Beloit Drive Sacramento, CA 95838 Fax: (916) 568-4246
Sarah E. Leeper <i>Vice President - Legal, Regulatory</i>	sarah.leeper@amwater.com	555 Montgomery Street Suite 816 San Francisco, CA 94102 Fax: (415) 863-0615
Nicholas Subias Director, Legal – Regulatory	nicholas.subias@amwater.com	555 Montgomery Street Suite 816 San Francisco, CA 94102 Fax: (415) 293-3024
Melody Singh <i>Financial Analyst III – Rates & Regulatory</i>	melody.singh@amwater.com	4701 Beloit Drive Sacramento, CA 95838 Fax: (916) 568-4260

Cities and counties that need Board of Supervisors or Board of Commissioners approval to protest should inform the Water Division, within the 20-day protest period, so that a late filed

protest can be entertained. The informing document should include an estimate of the date the proposed protest might be voted on.

The actions requested in this advice letter are not now the subject of any formal filings with the California Public Utilities Commission, including a formal complaint, nor action in any court of law.

This filing will not cause the withdrawal of service, nor conflict with other schedules or rules.

If you have not received a reply to your protest within 10 business days, please contact me at (916) 568-4222.

CALIFORNIA-AMERICAN WATER COMPANY

/s/ Jeffrey T. Linam

Jeffrey T. Linam
Director – Rates & Regulatory