

Date of Hearing: April 21, 2021

ASSEMBLY COMMITTEE ON UTILITIES AND ENERGY

Chris Holden, Chair

AB 1250 (Calderon) – As Introduced February 19, 2021

**SUBJECT:** Water and sewer system corporations: consolidation of service

**SUMMARY:** Establishes the Consolidation for Safe Drinking Water Act of 2021 and the timeframes by which the California Public Utilities Commission (CPUC) must review requests for water system consolidations. Specifically, **this bill:**

- 1) Makes legislative findings about public and state small water system compliance with drinking water standards, and about the merit of water system consolidations.
- 2) Defines "consolidate" as joining two or more public water systems, state small water systems, or affected residences not served by a public water system into a single public water system.
- 3) Requires the CPUC to approve or deny applications for consolidation within 8 months of filing.
- 4) Allows a consolidation valued at \$5 million or less to file an advice letter to obtain approval from the CPUC, and for the CPUC to approve the consolidation if the advice letter is uncontested within 120 days of filing.
- 5) Allows the CPUC to designate a different application procedure for consolidations valued at \$5 million or less if a more comprehensive review is warranted.

**EXISTING LAW:**

- 1) Declares that every human being has the right to safe, clean, affordable, and accessible water adequate for human consumption, cooking, and sanitary purposes. (Water Code § 106.3)
- 2) Defines "public water system" as a system providing water for human consumption that has 15 or more service connections, or regularly serves at least 25 individuals daily at least 60 days out of the year. This includes both public municipal water agencies and privately-owned water corporations. (Health & Safety Code (HSC) § 116275 (h))
- 3) Defines "state small water system" as a system providing water for public and human consumption that serves at least five, but not more than 14, service connections and does not regularly serve drinking water to more than an average of 25 individuals daily for more than 60 days out of the year. (HSC § 116275 (n))
- 4) Requires the State Water Resources Control Board (State Water Board), in administering Safe Drinking Water Act programs, to fund improvements and expansions of small community water systems, encourage consolidation of small community water systems that serve disadvantaged communities, and prioritize funding for construction projects that physically restructure two or more community water systems, at least one of which is

a small community water system that serves a disadvantaged community. (HSC § 116326)

- 5) Authorizes the State Water Board, where a public water system or a state small water system within a disadvantaged community consistently fails to provide an adequate supply of safe drinking water, to order consolidation with a receiving water system. Provides that the consolidation may be physical or operational. (HSC § 116682 (a))
- 6) Makes legislative findings that regional solutions to water contamination problems are often more effective, efficient, and economical than solutions designed to address solely the problems of a single small public water system, and that it is in the interest of the people of the State of California to encourage consolidation of the management and the facilities of small water systems to better address their water contamination problems. (HSC § 116760.10 (h))
- 7) Prohibits a public utility from merging or consolidating its property, or franchises or permits or any part thereof, without first having either secured authorization from the CPUC for qualified transactions valued above \$5 million or, for qualified transactions valued at \$5 million or less, filed an advice letter and obtained approval from the CPUC authorizing it to do so. If the advice letter is uncontested, authorizes the CPUC to approve the request. Provides that any merger, acquisition, or control without that prior authorization from the CPUC shall be void and of no effect. (Public Utilities Code (PUC) §§ 851 (a), 854)
- 8) Requires the CPUC to determine the types of transactions valued at \$5 million or less that qualify for advice letter handling. Authorizes, for a qualified transaction valued at \$5 million or less, the CPUC to designate a procedure different than the advice letter procedure if it determines that the transaction warrants a more comprehensive review. (PUC § 851 (a))
- 9) Requires, absent protest or incomplete documentation, the CPUC to approve or deny the advice letter within 120 days of its filing by the applicant public utility. (PUC § 851 (a))
- 10) States that no public utility, subsidiary, affiliate, or corporation holding a controlling interest in a public utility shall purchase or acquire, take or hold any part of the capital stock of any other public utility without having been first authorized to do so by the CPUC. (PUC § 852)
- 11) States the intent of the Legislature is that transactions with monetary values that materially impact a public utility's rate base should not qualify for expedited advice letter treatment. (PUC § 853 (d))
- 12) Requires the CPUC, in a ratesetting case (which includes acquisitions), to resolve issues within 18 months of the date the proceeding is initiated, unless the CPUC makes a written determination that the deadline cannot be met, including findings as to the reason, and issues an order extending the deadline. (PUC § 1701.5 (a))

- 13) Authorizes the CPUC to specify a resolution date later than 18 months from the date the proceeding is initiated, if specific reasons are provided for the necessity of a later date and the commissioner assigned to the case approves the date. (PUC § 1701.5 (b))

**FISCAL EFFECT:** This bill is keyed fiscal and will be referred to the Appropriations Committee for its review of the fiscal effect of this bill.

**BACKGROUND:**

*Oversight of California's drinking water systems* – The CPUC regulates investor-owned water corporations (IOUs) to ensure that ratepayers have access to safe and reliable water utility infrastructure and services. In comparison, the State Water Board has regulatory authority over the quality of the state's water resources and drinking water. In other words, the State Water Board is involved with the quality of the water, whereas the CPUC is involved with the supply and access to that water. As such, the state's drinking water systems are not governed by any one body. The following describe the various groups with regulatory oversight of California's drinking water systems:

- *CPUC:* The CPUC Water Division regulates over 100 investor-owned water and sewer utilities providing water service to about 16 percent of California's residents. Approximately 95 percent of that total is served by nine large water utilities each serving more than 10,000 connections. Annual water and wastewater revenues under the CPUC's regulation total \$1.4 billion.<sup>1</sup>
- *Publicly owned water utilities:* The majority of California's water customers are served by cities, water districts, and mutual water companies, which are governed by local boards. These utilities are not regulated by the CPUC.
- *State Water Resources Control Board:* The State Water Board has general authority with regard to water quality and drinking water functions, and administers provisions relating to public water systems and regulation of drinking water to protect public health. These include establishing drinking water standards, maximum contaminant levels in drinking water, and permitting public water systems. The State Water Board oversees approximately 7,500 public water systems which are also overseen by either the CPUC or local boards.<sup>2</sup>

*Public water systems* – As defined in existing law above, a public water system provides water for human consumption to 15 or more connections, or serves 25 or more people daily for at least 60 days out of the year. These systems include large city or regional water suppliers, small housing communities, businesses, schools, and restaurants. A public water system is not necessarily a public entity, and most are privately owned.<sup>3</sup>

Approximately 92% of public water systems serve less than 1,000 connections.<sup>4</sup> Small public water systems are often less resilient to natural disasters, such as drought and fire, have more

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<sup>1</sup> <https://www.cpuc.ca.gov/water/>

<sup>2</sup> [https://www.waterboards.ca.gov/drinking\\_water/certlic/drinkingwater/waterpartnership.html](https://www.waterboards.ca.gov/drinking_water/certlic/drinkingwater/waterpartnership.html)

<sup>3</sup> *What is a Public Water System?* California Water Boards

<sup>4</sup> [https://www.waterboards.ca.gov/drinking\\_water/certlic/drinkingwater/waterpartnership.html](https://www.waterboards.ca.gov/drinking_water/certlic/drinkingwater/waterpartnership.html)

difficulty adjusting to regulatory changes, and may struggle to fund infrastructure maintenance and replacement due to poor economies of scale and lack of staff. As a result, the State Water Board supports water consolidations whenever feasible, a component of the Safe and Affordable Fund for Equity and Resilience (SAFER) program.

In a 2021 assessment, the State Water Board found that of 2,779 public water systems, with 3,300 service connections or less, 52% (1,284) were considered safe, regarding water quality, accessibility, or affordability concerns.<sup>5</sup> These systems serve approximately 2 million customers (73.5% of population served by public water systems). The remaining 48%, about 700,000 customers, are served by at-risk or potentially at-risk water systems. The majority of these at-risk or potentially at-risk water systems are located in or near the San Joaquin Valley.<sup>6</sup>

*Need for water system consolidation* – Consolidation is the physical or managerial joining of two or more water systems, which often consists of a smaller system being absorbed into a larger water system. Managerial consolidation is when a small water system becomes part of a larger water system for all managerial purposes, but continues to use their original water supply and distribution system.

Restructuring can be an effective means to help small water systems achieve and maintain technical, managerial, and financial capacity, and to reduce the oversight and resources that states need to devote to these systems. The United States Environmental Protection Agency (US EPA) and State Water Board maintain that water system consolidation reduces cost, improves reliability, and extends service from existing public water systems to communities and areas that currently rely on under-performing or failing small water systems.<sup>7,8</sup> Prior legislation has recognized the value of water system consolidations. SB 88 (Committee on Budget and Fiscal Review, Chapter 27, Statutes of 2015) authorized the State Water Board to require a failing public water system or state small water system serving a disadvantaged community to consolidate with a compliant public water system.

*CPUC regulation of water system consolidation* – The CPUC must approve all water system consolidations that involve CPUC-regulated water utilities. It uses two methods for these approvals: (1) Applications – where the consolidation involves the acquisition of a CPUC-regulated public water system by another CPUC-regulated public water system; and (2) Advice Letters – where the consolidation involves the acquisition of a public water system not regulated by the CPUC by a CPUC-regulated public water system and where certain conditions are met.

Currently, applications undergo a formal legal process with an administrative law judge (ALJ) and starts with an 18-month timeline (although the ALJ or the Assigned Commissioner can extend this deadline, with Commission approval, at their discretion). These formal proceedings take a considerable amount of time because they usually involve complex issues that require analysis, provide an opportunity for public meetings and public participation workshops, and consider recommendations by affected parties through the judicial process. Acquisitions through advice letters generally involve small, unprotested transactions where rates for existing and

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<sup>5</sup> 2021 *Drinking Water Needs Assessment*. California Water Boards. April 2021.

<sup>6</sup> Figure 17. *Ibid*.

<sup>7</sup> [https://www.waterboards.ca.gov/drinking\\_water/certlic/drinkingwater/waterpartnership.html](https://www.waterboards.ca.gov/drinking_water/certlic/drinkingwater/waterpartnership.html)

<sup>8</sup> *Water System Partnerships: State Programs and Policies Supporting Cooperative Approaches for Drinking Water Systems*. EPA 816-S-17-002. August 2017

acquired customers will not be adversely impacted. Advice letters do not provide an opportunity for public meetings or public workshops, and the time frame to protest an advice letter is shorter than it is for an application.

The CPUC has in recent years required water utilities to file applications for acquisitions of municipal water systems instead of advice letters, particularly if there may be rate impacts for either the existing system's customers or the acquired system's customers. For example, recent acquisitions of municipal water systems, such as Bellflower and Montebello, were requested through formal applications because they have been protested, raise important policy questions, and could result in increased rates for existing customers.

Since 2007, 29 water IOUs have acquired water systems. In addition, there are currently five proposed acquisitions in progress: four by application (East Pasadena, Warring Water Co., Bellflower, and Montebello) and one by advice letter (Robbins Water System in Sutter County).

*Current expedited process for small water systems with health and safety violations* – The CPUC's current rules provide a process to help expedite the acquisition of small water utilities with failing water systems, referred to as "Inadequately Maintained and Operated Small Water Systems (IMOSWS)." Per CPUC decision 99-10-064, an advice letter process can be used to transfer assets of IMOSWS instead of the application process. An IMOSWS is defined as any water system serving fewer than 2,000 customers that is subject to a compliance order or citation related to drinking water standards. According to the CPUC, this process has been utilized in 2020 for consolidation of the Rolling Hills Water System with the Bakman Water Company in Madera.<sup>9</sup>

*The Public Advocates Office on approval timelines* – The Public Advocates Office (PAO) is an independent organization within the CPUC that advocates on behalf of utility ratepayers to achieve safe and reliable water service at the least possible cost.<sup>10</sup> The PAO conducts a public interest review of water IOU applications seeking approval to acquire other water systems. Historically, the PAO has stated that it supports expedited CPUC treatment only of proposed acquisitions of troubled, inadequately operated, and maintained small water utilities (i.e., with 2,000 or less customer connections) that are subject to an outstanding order of the State Water Board to implement improvements to address violations in the state's safe drinking water standards. They also noted that the advice letter process is the CPUC's expedited process and is appropriate in these circumstances. They have stated that the CPUC's formal application process is necessary for rigorous evaluation of strategic business acquisitions to ensure they are in the public interest and transparent to all ratepayers that will be impacted.

## COMMENTS:

- 1) *Author's comment.* "AB 1250 dictates the timelines for small water system consolidations when approval by the California Public Utilities Commission (CPUC) is needed. Currently, many smaller water systems in our state cannot afford, or are unable to raise rates sufficiently, to make the improvements necessary to provide clean drinking water to residents. These systems may decide to sell their system, customer-owners of a mutual water company vote to sell their system, or after residents in a municipality vote to have

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<sup>9</sup> CPUC Resolution W-5214

<sup>10</sup> <https://www.publicadvocates.cpuc.ca.gov/>

their system consolidated into another water utility. Unfortunately, some consolidation applicants have experienced CPUC approval backlogs, waiting as long as 24 months before they can provide clean water to a community. This bill will set deadlines for the completion of small water system consolidations, requiring CPUC consolidation approval or denial within 8 months for applications and 4 months for advice letters.”

- 2) *Need for expedited application review.* The author and sponsors of this bill note the desire to speed up the consolidation process in order to provide residents with the clean and safe drinking water they deserve. This bill will shorten the timeframe, from 18 to 8 months, by which the CPUC must approve or deny applications for acquisitions, and will make it easier for IOUs to process water consolidation transactions with smaller systems through the advice letter process instead of the application.

The average length of time for the CPUC to approve water system acquisitions over the last five years appears to be around 500 days; however, two acquisitions over the last five years have stretched to over 700 days and two other to more than 800 days.<sup>11</sup> In this regard, it seems justifiable for the state to ensure that residents who are served by failing water systems receive resolution to a consolidation request within a reasonable timeframe.

- 3) *Potential impacts on ratepayers.* Water system consolidations can at times involve increased costs to ratepayers which warrant a thorough review. As noted by the PAO, consolidations can be complex matters involving legal questions and require more time. The volume of work on the CPUC; limited staff resources dedicated to water utility issues; the workload of the administrative law judges; public meetings, public participation, and other requirements involved in contested proceedings; as well as the nuances of individual acquisition cases can impact approval time. In addition, the parties in the proceeding, usually the purchasing utility and the PAO, discuss at length the purchase price. The PAO has a duty to protect ratepayer dollars, so they scrutinize the transactions happening before the CPUC. Under an expedited advice letter process, the PAO and CPUC staff would have less of an opportunity to complete a thorough vetting of consolidation transactions.

This bill addresses the need for improved access to clean drinking water for California residents. However, this need must be balanced against the potential impacts on ratepayers that could arise from limiting opportunities for a thorough vetting, including the loss of opportunities for public input. This bill may also be duplicative of the current expedition process that allows for water systems in violation of quality standards to request consolidation via advice letter. Presumably, the issues raised by the author could be resolved through existing procedures for public water systems serving under 2,000 customers. It is unclear whether the benefits of expediting the application timeline for all other water system consolidations would outweigh potential costs to ratepayers.

- 4) *Prior legislation.*

SB 88 (Senate Committee on Budget and Fiscal Review) authorized the State Water Board to require certain water systems that consistently fail to provide safe drinking

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<sup>11</sup> As reported to the Committee by the CPUC on April 9, 2021

water to consolidate with, or receive an extension of service from, another public water system. Status: Chapter 27, Statutes of 2015.

AB 2501 (Chu) provides additional authority to the State Water Board to order consolidations. Status: Chapter 871, Statutes of 2018.

SB 200 (Monning) establishes the Safe and Affordable Drinking Water Fund which provides \$130 million per year to develop and implement solutions for small systems in violation of safe drinking water standards. Authorizes the money to be spent on operations and maintenance costs, cost of consolidating with larger systems, provision of replacement water, and funding for administrators to run the small systems. Status: Chapter 120, Statutes of 2019.

AB 1751 (Chiu, 2019) would have established timeframes by which the CPUC is required to take action on a request for water system consolidation. The final version of AB 1751 was substantially similar to AB 1250. Status: Held on the suspense file in the Senate Committee on Appropriations.

SB 1096 (Caballero, 2020) would have established timeframes by which the CPUC is required to take action on a request for water system consolidation. SB 1096 was substantially similar to AB 1250. Status: The referral of SB 1096 to the Senate Committee on Environmental Quality was rescinded due to the shortened 2020 Legislative Calendar.

## **REGISTERED SUPPORT / OPPOSITION:**

### **Support**

Association of California Water Agencies (ACWA)  
California American Water  
California Water Association (SPONSOR)  
California Water Service  
Great Oaks Water Company  
Liberty Utilities  
Regional Water Authority  
San Gabriel Valley Water Company

### **Opposition**

None on file.

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