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The Weekly Wrap



February 10-17, 2012

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TO: CWA Member Companies
FROM: Jack Hawks, Executive Director
SUBJECT: Highlights for the Weeks Ending February 10th and 17th, 2012

NARUC Water Committee Gets Earful on IOWC COC, Infrastructure—The National Association of Regulatory Utility Commissioners (NARUC) met Feb. 5-8 in Washington, D.C. for its annual Winter Committee Meeting, and the Committee on Water had an agenda chock-full of substantive issues for the state regulators attending to absorb. Among them were five presentations/panels on water main and pipeline (and related infrastructure) assessment, prioritizing, investment and replacement. Of note was Brian Pallasch's presentation of the new report from the American Society of Civil Engineers on which I reported in late December titled *Failure to Act: The Current Investment Trends in Water and Wastewater Infrastructure*. You'll recall that its main finding was the growing gap between actual and needed infrastructure investment in water and waste-water systems – from \$54.8 billion in 2010 to 143.7 billion in 2040 (in constant 2010 dollars).

The pipeline replacement presentations were equally compelling, and I thought the company representatives from New Jersey American Water, United Water and Aqua America did a good job of communicating the company approaches to the regulators. The subject matter they tackled involved acoustic diagnosis of pipeline condition, non-invasive pipeline assessment and the evaluative criteria for replacement prioritization. It was interesting to see how the East Coast water utilities manage their pipeline inventories and replacement decisions.

The always-sensitive subject of benchmarking was addressed in a three-part presentation by PA PUC executive Steve Klick, American Water's Stephen Schmitt and CH2MHill's Scott Haskins. They framed the issue for the regulators by providing important guiding principles on metrics, including having utilities set their performance standards (with PUC endorsement, of course) and then comparing current performance to those targets. Doing this avoids inconclusive and unproductive comparisons between utilities.

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The second day's meeting dealt with customer service, a "frank" regulatory discussion, a new evaluative tool for financing, the latest from the Water Research Foundation, and the regular report from the National Association of Water Companies (NAWC), including an overview from NAWC Executive Director Michael Deane on the association's social media program. It was as equally compelling as the first day.

Following a presentation on EPA's Water Sense Program, United Water Regulated Business President Dennis Ciemniecki showcased United's new multi-state customer service/customer information system (CIS), which is a \$38 million investment that includes a new Oracle Customer Care & Billing System. Among other things, the Oracle system is allowing United to optimize its 28 CIS interface and integration points in a manner that is providing employees with the necessary process functionality and "product roadmap" to greatly enhance the customer communications and care.

Utilities, Inc. President & CEO Lisa Sparrow, who is also the current NAWC President, followed with an unusually direct presentation about the current regulatory environment for water utilities nationwide. Basically, she told the regulators that the sum of water utility capital intensity, aging infrastructure/replacement needs, low depreciation rates, growing EPA mandates, tight credit markets and increasingly tighter supplies, coupled with dramatic decreases in consumption and sales, ever-increasing expenses and very limited growth, means that regulated utilities cannot and are not earning their authorized rates of return.

She explained that the traditional remedies—e.g., customer growth, periodic assists from the weather, cutting costs, etc. —don't work anymore. Even "progressive" ratemaking can't solve the problem, she said, because the regulatory lag created by the sales declines, operating cost increases and capital expenditure programs at three times depreciation create too big a deficit at the outset. She noted that a combination of NAWC's best practices, which have been endorsed generally by the NARUC Water Committee, plus innovative ratemaking (decoupling) and formula approaches to returns on equity, is a good place for utilities and regulators to start in solving the problem.

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One of those solutions was offered in the next presentation, from Paula Ahern and Frank Hanley of AUS Consultants, titled “A New Card on the ROE Table.” In addition to the three traditional approaches for determining a utility’s return on equity (ROE) – discounted cash flow (DCF), capital asset pricing model (CAPM) and risk premium, AUS has developed an adjunct to RP called the “Predictive Risk Premium Model” (PRPM), which they are promoting as a new way to estimate a utility’s ROE for ratemaking purposes. Basically, this approach examines a company’s historical volatility in both its stock price and actual returns over time and uses that information to “predict” its future equity risk premium.

The proponents suggest that this approach has much less subjectivity and fewer restrictive assumptions than other RP models. They noted that the PRPM has yet to be used by any PUC jurisdiction in the country to determine utility ROEs (water and otherwise), but AUS has a strong connection with many state PUCs so it will be interesting to see if it gains any traction. I can send you the slide presentation and published article on the PRPM if you’re interested.

CWA’s Sharun Carlson attended NARUC’s Subcommittee on Utility Market Access (UMA) meeting on Feb. 5th, and she reported on a new resolution encouraging inclusion of historically black colleges and universities (HBCUs) in development of long-term strategic partnerships to address pending retirements of utility professionals. On Feb. 8th, the NARUC Board of Directors adopted the resolution, which states that the Board supports enhanced efforts to include HBCUs within the development of long-term utility workforce plans to cultivate new talented and diverse professionals for the utility industry including utility regulatory agencies.

The UMA Subcommittee also had a panel on “What Markets Have in Place for Future Utility Workforce Replacement.” Among the panelists was Sempra Energy’s Nancy Smith-Taylor, who outlined Sempra’s commitment to encouraging diversity in its new hires as it replaces its aging workforce. She discussed the challenges Sempra is facing in finding new engineers, especially women.

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The NARUC Winter Meeting concluded with NAWC's usual magnificent dinner at the Anderson House museum and research library in the Dupont Circle neighborhood of Washington. More than one commissioner has told me the NAWC dinner is the event they most look forward to at every NARUC meeting.

Antipathy Toward PUC, PG&E Manifests Itself in Bills Affecting Commission—

CWA Legislative Advocate and Nossaman Senior Policy Advisor Meg Catzen-Brown noted in her Feb. 10 monthly report to CWA's Board of Directors that several bills resulting from the PG&E San Bruno disaster of 2010, and the subsequent public media criticism of the California PUC and President Peevey, are moving through the legislative process. One is Assembly Bill 838 (Hill), which would require the CPUC to appoint an assistant executive director for public safety. That position's responsibility would be to "coordinate all actions of all divisions of the Commission to ensure [that] public safety is a primary goal in all proceedings held by the Commission." The bill cleared the Assembly on a vote of 54-19 late last month and was referred Feb. 16th to the Senate energy, Utilities & Communications Committee.

AB 1197 (Hill), which would have required the CPUC to establish a "whistleblower protection program" to protect public utility employees, former employees, and utility contractors and subcontractors from retaliation for disclosing information pertaining to public safety to the CPUC or any other government agency, died in the Assembly Appropriations Committee on Feb. 1st. It's not clear yet whether Hill will reintroduce the bill this year before the Feb. 29th deadline.

Two San Bruno-related bills that could well affect the water utilities have been introduced, and both would subject the CPUC to the Public Records Act (from which it is now exempt): Senate Bill 1000 (Yee) and AB 1541 (Dickinson). SB 1000 would require that any order or recommendation made by the CPUC, and any accident report filed with the CPUC pursuant to public utility accident requirements, be made available and ready for public review in compliance with the California Public Records Act.

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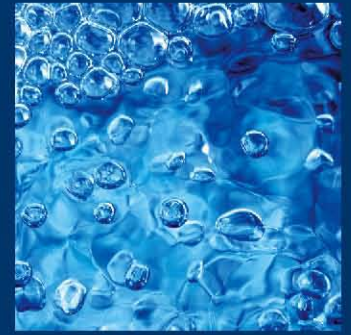
Currently, the Public Utilities Act prohibits the CPUC an officer or employee of the Commission from disclosing any information furnished to the CPUC by a public utility, a subsidiary, an affiliate, or corporation holding a controlling interest in a public utility, unless the information is specifically required to be open to public inspection under the act, except on order of the CPUC or a commissioner in the course of a proceeding. This bill would repeal that prohibition and require the California Public Records Act to apply to all records of, and records filed with, the CPUC unless expressly exempt from disclosure by other provisions of the Public Utilities Code or the California Public Records Act. AB 1541 is essentially the Assembly equivalent of SB 1000. Both have just been referred to their respective committees.

Two other annoying bills that have been introduced recently in the aftermath of San Bruno are SB 982 (Evans) and SB 981 (Yee). SB 982 would require a corporation with shareholders in California to issue an annual report on its past and planned political contributions. SB 981 is a “revolving door” measure that would prohibit a CPUC commissioner or executive employee from becoming an employee or agent of a regulated utility for two years upon leaving employment of the CPUC. The bill also would also impose the same two-year ban on a former utility employee or agent seeking employment as a CPUC executive employee or Commissioner.

Finally, AB 1514 (B. Lowenthal) has been introduced as a measure that would allow the CPUC to enforce the state’s excavation laws. CWA’s Legislative Committee will be reviewing all of these bills, as well as the Public Records Act, to ascertain the likely impact on water companies, and whether it will be necessary to seek appropriate water company exemptions.

Revenue Declines, Focus on Private Sector Water Highlight UWI Conference—The Urban Water Institute held its Spring Conference Feb. 9-10 in Palm Springs (where, of course, it actually was Spring in February), and most of the first afternoon, surprisingly, was devoted to private-sector water issues. California American Water’s Kevin Tilden and I were on the program, making separate presentations on how private water companies communicate the value of water (Kevin) and on whether privatization of water is an option (me). Additionally, there were two excellent presentations on public-private partnerships.

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The remainder of the first day was devoted to the same subject bedeviling the entire water utility industry – the future of water costs and rates. Indeed, one of the panels on the subject “How Should Cities and Water Districts Respond?” featured speakers from various public agencies and consulting firms, several of whom very matter-of-factly said cities and districts must design their rates such that their fixed cost recovery must come from their service charges and the first tier of their tiered rates. It was an interesting revelation from the public sector agencies.

Kevin explained how one of the basic tenets of an effective public relations program, consumer/customer research, underpins American Water’s external communications on the value of water. He summarized eight different “national conversations” on the value of water and the need to price it at full cost, ranging from work done by the Johnson Foundation to ITT Corporation to a March 2011 Gallup Poll. This research conveyed three key points: 1) Water has risen to the top of the list of environmental concerns; 2) the gap between actual infrastructure investment and needed investment continues to grow, approaching \$1 trillion for water and wastewater combined; and 3) America will continue to resist solving its water needs until water is priced at, and consumers pay, the full cost of water.

Kevin told the attendees that messaging opportunities are abundant and that headlines saying customers cannot afford a proposed rate increase can be overcome over time. For instance, he noted that while only 17% of customers in a particular survey knew that drinking water from the tap costs only about a penny a gallon, once they learned of this fact, 94% of them considered a penny to be a somewhat to very reasonable cost. Kevin showed several examples like this where consumer knowledge gaps exist between cognition and fact, and how effective communications programs can close this gap. He also noted how important it was for water companies to rely on third parties to help convey their key messages. He concluded with examples of California American Water’s value of water campaign and left the audience pondering questions related to whether the ‘penny a gallon’ message encourages waste, what more can be done to help employees be messengers and what else can we do to shape the value of water message.

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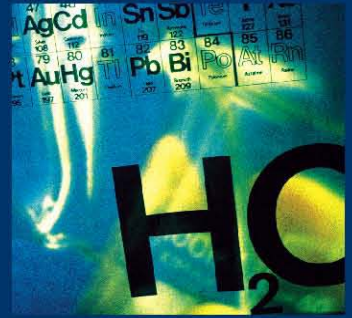
I didn't relish standing in front of 150 public water agency executives talking about privatization, especially after Kevin's help and constructive presentation. Nevertheless, that was my assignment, and I pointed out that privatization in the purest sense (transferring ownership of public assets to a private entity) was fairly rare and that public-private partnerships (P3s), which are not privatization, actually predominated. I reviewed the many benefits of P3s for public agencies, as well as the considerations that should be foremost for municipalities as they consider privatization options. Since rates between public and private utilities are always an issue brought up by opponents, I addressed this one directly, drawing on many of the points CWA made in its 2010 white paper on the reasons why water utility rates cannot be accurately compared.

I also explained that PUC-regulated water utilities are open to P3 opportunities, either ownership or a P3 hybrid, but that the transaction must fit the municipality's needs and that any opportunity necessarily turns on the public entity's preferences. I said investor-owned water companies (IOWCs) don't often make unsolicited proposals and that they most often participate in RFPs when the public agency is seeking a partnership or asset sale. I closed with the IOWCs' principal concern, condemnation, and explained the difficult, lengthy and costly process involved. I also showed the Felton example, demonstrating how that condemnation has backfired, with not only customer costs starting out in 2008 higher than the previous regime under California American Water, but also noting that rates have gone up more than 30 percent since then, even while "local control" disappeared when San Lorenzo Valley WD closed CAW's local office. I think the presentation was reasonably well received, and I'm glad CWA got the opportunity to address the issue in a public agency-dominated audience.

Revised PD on Sand City Withdrawn; San Clemente Dam PD Held Until April—

At its Feb. 16th Open Meeting, the California PUC continued to stay the two major Proposed Decisions (PDs) affecting California American Water (CAW). Commissioner Sandoval has put a hold until April 19th on Administrative Law Judge Christine Walwyn's PD on the ratemaking treatment of the San Clemente Dam removal project. As you know, not only had Walwyn proposed minimum recovery on the removal project, but also she threatened a Rule 1.1 violation proceeding against the company.

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Let's hope Comr Sandoval's review will produce a more reasonable outcome. In contrast, the application and ALJ Marianne Bushey's PD on CAW's lease to obtain water from the Sand City Desalination Plant, which denied approval of the lease, but created a purchased water option based on the alternative ratemaking methodology, has been withdrawn. We'll see what happens with this proceeding, as well. In other action, the Commission:

- Approved **Decision 12-02-023**, which resolved a complaint proceeding by some residents against the Sunbird MobileHome Park. The decision approves a partial settlement agreement and sets water rates and conditions of water service for MobileHome Park.
- Approved **Resolution W-4904**, which grants PureSource Water, Inc. a general rate increase to produce \$16,317 (30.39%) in additional annual revenue for Test Year 2011 and which allows PureSource to establish facilities fees.
- Approved **Resolution W-4905**, which grants West San Martin Water Works, Inc. a general rate increase to produce \$97,219 (32%) in additional annual revenues for Test Year 2011.
- Approved **Decision 12-02-027**, which grants a modification of D.11-11-018 to correct errors in the settlement agreement involving San Gabriel Valley Water's L.A. Division GRC. It reduces total revenue requirement from \$69,973,500 to \$63,682,700.
- Approved **Resolution W-4906**, which grants Agate Bay Water Co. a Rate Base Offset Revenue Increase that will produce additional annual revenue of \$14,088, or 4.0%.
- Approved **Resolution W-4907**, which grants Stewart Water Co. an exemption from Commission jurisdiction.

CUWCC Board Approves Composition of BMP 1.4 Revision Committee—The California Urban Water Conservation Council Board of Directors met Feb. 8th and approved a staff recommendation start the process of revising Best Management Practice 1.4 (formerly BMP 11), which as you know, calls for water utilities to derive at least 70 percent of their total revenues from their quantity rates. The Board approved this recommendation:

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- Begin the process of nominating Committee members for a Water Rates BMP Refinement Committee by agreeing to the type of members being sought.

You may recall that the BMP 1.4 revisions adopted in 2007 envisioned a review of the BMP within five years of adoption. The relevant language then said that within five years of the adoption of the BMP revision, the Council shall reconvene the BMP 11 Revision Programmatic Action Committee (PAC) to: 1) assess the rate of compliance with the revised BMP, 2) identify barriers to implementation, 3) assess its compatibility with Proposition 218 requirements, 4) initiate a water savings assessment appropriate to the data and project resources available to the Council, and 5) develop further refinements as needed to improve the BMP's effectiveness.

The recommendation calls for the PAC to include representatives from:

- Council Group 1 member organizations in all three geographic regions;
- Several representatives from Group 2 organizations;
- At least 2 representatives from Group 3 members who have an expertise in water rates;
- At least one expert in water rates from academia or the professional consulting world that has authored a peer reviewed paper on the topic;
- Liaison(s) from other California Water Associations which deal with rates and support water conservation;
- At least one representative from a utility finance background;
- At least one representative from a Utility Management position (CEO or COO);
- At least one representative from an IOU.

In order to keep the eventual Committee to a reasonable size, all of these positions are envisioned as potentially filled by one person who represents more than one of these types (i.e., the Finance Director may be from an IOU, etc.). Despite this restriction, I will attempt to be one of the two Group 3 representatives on the PAC, in addition to a separate CWA member company representative as the IOU member. Failing this, I will confer with CWA's Directors and Regulatory Committee to determine whether they want me or one of the member company rate experts to be the IOU member of the PAC.

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Senate Finance Panel Backs Proposal to Lift PAB Volume Cap—The Finance Committee of the U.S. Senate approved a bill Feb. 7th that would eliminate the annual volume cap for six years on private activity bonds (PABs), which allow the private sector to participate in financing public projects. For our industry, the cap is the level of financing that can be raised through private tax-exempt bonds to fund drinking water and wastewater infrastructure repairs. The amendment was added to a measure that will fund the surface transportation bill.

The amendment was offered by Sen. Robert Menendez (D-N.J.), and it would amend the Internal Revenue Code by removing the cap on the amount that municipalities may raise through PABs for water and wastewater projects. The Finance Committee approved the financing package on a 17-7 vote. It will be added on the Senate floor to an underlying surface transportation reauthorization bill, known as the Moving Ahead for Progress in the 21st Century. The bill, S. 1813, is now scheduled for a full Senate roll call vote on Feb. 27th.

As you may know, the federal government limits the use of these bonds by the private sector for public projects. Each state has a cap on the amount of private activity bonds it can issue for eligible projects that include water and wastewater infrastructure projects. In 2009, the state cap was equal to \$90 per resident or \$273.09 million.

The Menendez amendment is similar to the Sustainable Water Infrastructure Investment Act of 2011 (S. 939, H.R. 1802), which he and Rep. Bill Pascrell (R-N.J.) introduced in May. Their bill, however, would have permanently removed the cap, while the amendment approved by Senate Finance would lift the volume cap for six years. National Association of Water Companies Executive Director Michael Deane said in a Bloomberg BNA article that he was pleased “the Senate has recognized the critical need and helped to bring more investment into water and wastewater infrastructure repairs.” Given the constrained finances of states and localities, this amendment will allow public-private financing for these projects, he said.

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Upcoming Industry Meetings/Conferences/Events:

- February 22, 2012 – CII Task Force Metrics Subcommittee Meeting (12:00n – 2:00p; East Bay MUD; 375 11th St., Oakland 94607); J. Hawks will attend.
- March 3, 2012 – “A Primer on Water and the Delta” (8:30a-12:00 Noon; Stockton Civic Auditorium; 525 N. Center St., Stockton CA 95202)
- March 5, 2012 – NAWC Government Relations Committee Meeting (10:30a – 2:30p; Hotel George, Washington, DC); J. Hawks will attend.
- March 6-7, 2012 – NAWC/CWA – Annual Congressional Fly-In; Capitol Hill, Washington, DC; J. Hawks will participate.
- March 8, 2012 – California PUC Open Meeting (9:00a – 12:00p; 505 Van Ness Ave., San Francisco 94102)
- March 8-9, 2012 – Annual California Water Policy Conference – “From Water Woes to Water Wise” (Westin Hotel – LAX; 5400 West Century Blvd., Los Angeles, CA 90045)
- March 12, 2012 – CWA Legislative Committee Meeting (10:00a-3:00p; Nossaman Office – 915 L St., Suite 1000, Sacramento 95814); J. Hawks will attend.
- March 14, 2012 – California Urban Water Conservation Council Plenary Meeting (9:30a-3:00p; SF State University; 865 Market St., San Francisco 94102); J. Hawks will attend.
- March 15, 2012 – CWA Directors Meeting (9:30a-2:30p; Manhattan Beach Country Club; 1330 Parkview Ave., Manhattan Beach 90266)
- March 22, 2012 – California PUC Open Meeting (9:00a – 12:00p; 505 Van Ness Ave., San Francisco 94102)
- March 25-27, 2012 – Water Reuse Association - 2012 WaterReuse California Annual Conference (Sheraton Grand Hotel; 1230 J St., Sacramento 95814).
- March 27-28, 2012 – Water Education Foundation – 29th Annual Executive Briefing (8:30a-4:30p; Doubletree Hotel; 2001 Point West Way; Sacramento); J. Hawks will attend.

—CWA—