



CALIFORNIA WATER SERVICE

1720 North First Street
San Jose, CA 95112-4598 Tel: (408) 367-8200

October 23, 2019

Bruce De Berry
Interim Director, Water Division
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

VIA ELECTRONIC MAIL TO:
bruce.deberry@cpuc.ca.gov

Re: 2017-2018 Biennial Independent Audit for Affiliate Transactions

Director De Berry,

California Water Service Company ("Cal Water") hereby notifies the Commission that the company is not submitting an independent audit pursuant to the Commission's Affiliate Transactions Rules¹ ("Rules") because the audit requirement was not triggered for either 2017 or 2018.

Section VIII.E of the Rules requires utilities to have an independent audit conducted "if the sum of all *unregulated affiliates' revenue* during the last two calendar years exceeds 5% of the total revenue of the utility and all of its affiliates during that period" (emphasis added).

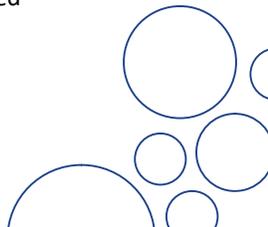
Consolidated Revenue

Exhibit A to this letter consists of pages from the Form 10-K that California Water Service Group ("CWS Group"), Cal Water's parent company, filed with the Securities and Exchange Commission for the year ending December 31, 2018. The total revenues for Cal Water and all of its affiliates are listed in the "Consolidated" columns, and were \$676,113,000 for 2017 and \$698,196,000 for 2018.

Unregulated Affiliates' Revenue

Note that the Form 10-K excerpt shows "operating revenue" for All Other Subsidiaries. In addition, under the category, "Other income and expenses," the Form 10-K provides "Non-regulated revenue" for CWS Group, Cal Water, and All Other

¹ *Modified Rules for Water and Sewer Utilities Regarding Affiliate Transactions and the Use of Regulated Assets for Non-Tariffed Utility Services* ("Affiliate Rules") of Appendix A to D.11-10-034 (originally adopted in Appendix A of D.10-10-019).





CALIFORNIA WATER SERVICE

Subsidiaries.² To determine which data sets are relevant to Section VIII.E of the Rules, please refer to **Exhibit B** to this letter, which is an excerpt from Cal Water’s Biennial Affiliate Compliance Plan.³

- As discussed under Section I.B of the Biennial Affiliate Compliance Plan, Cal Water has three regulated affiliates that are exempt from all of the Affiliate Transactions Rules except Rules IV.B and X. According to the specific terms of Section VIII.E, the revenue from these regulated affiliates are not relevant.
- Also discussed under Section I.B of the Biennial Affiliate Compliance Plan, Cal Water has three unregulated affiliates (CWS Group, HWS Utility Services, and CWS Utility Services).
- For the purposes of determining whether the independent audit requirement is triggered, it is sufficient to treat the “non-regulated revenue” listed for CWS Group and All Other Subsidiaries as potentially qualifying as “unregulated affiliates’ revenue” under Section VIII.E.⁴
- For example, the maximum amount in 2018 that should be considered “unregulated affiliates’ revenue” for Section VIII.E purposes is \$3,530,000.⁵ For 2017, the maximum amount is \$3,799,000.

Conclusion

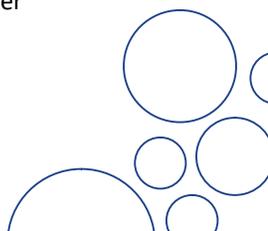
Based on the above analysis and the Form 10-K submitted to the Securities and Exchange Commission by CWS Group, the amount of Cal Water’s “unregulated affiliates’ revenue” as compared to total revenue does not meet the 5% trigger for either 2017 and 2018. Therefore, an independent audit under Section VIII.E of the Commission’s Affiliate Transactions Rules is not needed at this time.

² The Non-regulated revenue under the “Consolidating Adjustments” column reflects revenue transferred between affiliates. The amounts are listed here so that they can be removed from the calculation of the total non-regulated revenues listed under the “Consolidated” column.

³ Cal Water’s Biennial Affiliate Compliance Plan was submitted as Attachment D to its CPUC Annual Report for Calendar Year 2018.

⁴ The Non-regulated revenues listed under Cal Water relate to activities authorized under the Non-Tariffed Products and Services section of the Rules, and therefore do not fall within the definition of “unregulated affiliates’ revenue” in Section VIII.E.

⁵ This is the sum of \$2,333,000 for CWS Group and \$1,197,000 for All Other Subsidiaries. For Section VIII.E purposes, the amount is actually less because some of the “non-regulated revenue” listed under All Other Subsidiaries was generated by a regulated affiliate, and therefore does not qualify.





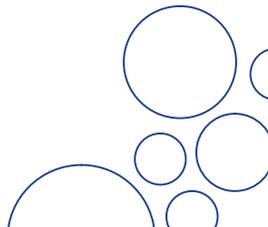
CALIFORNIA WATER SERVICE

Please feel free to contact me if you have any questions. Thank you.

/s/

Paul Townsley
Vice President, Corporate Development and Rates
ptownsley@calwater.com
408-367-8200

Cc: ora@cpuc.ca.gov - Elizabeth Nichols, Director, Public Advocates Office (CPUC)
Viet.Truong@cpuc.ca.gov - Trương, Việt "Kevin," Water Division



CALIFORNIA WATER SERVICE GROUP
Notes to Consolidated Financial Statements (Continued)
December 31, 2018, 2017, and 2016
Dollar amounts in thousands unless otherwise stated

Exhibit A

16 CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

CALIFORNIA WATER SERVICE GROUP
CONDENSED CONSOLIDATING STATEMENT OF INCOME
For the Year Ended December 31, 2018

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
	(In thousands)				
Operating revenue	\$ —	\$ 656,939	\$ 41,257	\$ —	\$ 698,196
Operating expenses:					
Operations:					
Purchased water	—	206,675	428	—	207,103
Purchased power	—	22,460	8,620	—	31,080
Pump taxes	—	14,664	—	—	14,664
Administrative and general	—	90,563	10,218	—	100,781
Other operations	—	73,521	6,930	(583)	79,868
Maintenance	—	23,573	921	—	24,494
Depreciation and amortization	94	78,601	5,173	(87)	83,781
Income tax (benefit) expense	(960)	17,678	948	923	18,589
Property and other taxes	—	24,190	3,106	—	27,296
Total operating (income) expenses	(866)	551,925	36,344	253	587,656
Net operating income	866	105,014	4,913	(253)	110,540
Other income and expenses:					
Non-regulated revenue	2,333	17,658	1,197	(2,916)	18,272
Non-regulated expenses	—	(22,122)	(665)	—	(22,787)
Other components of net periodic benefit cost	—	(8,886)	(422)	—	(9,308)
Allowance for equity funds used during construction	—	3,954	—	—	3,954
Gain on non-utility properties	—	50	—	—	50
Income tax expense (benefit) on other income and expenses	(652)	2,616	(63)	816	2,717
Net other income (loss)	1,681	(6,730)	47	(2,100)	(7,102)
Interest:					
Interest expense	1,711	38,288	2,251	(2,333)	39,917
Allowance for borrowed funds used during construction	—	(1,909)	(154)	—	(2,063)
Net interest expense	1,711	36,379	2,097	(2,333)	37,854
Equity earnings of subsidiaries	64,748	—	—	(64,748)	—
Net income	\$ 65,584	\$ 61,905	\$ 2,863	\$ (64,768)	\$ 65,584

CALIFORNIA WATER SERVICE GROUP
Notes to Consolidated Financial Statements (Continued)
December 31, 2018, 2017, and 2016
Dollar amounts in thousands unless otherwise stated

Exhibit A

16 CONDENSED CONSOLIDATING FINANCIAL STATEMENTS (Continued)

CALIFORNIA WATER SERVICE GROUP
CONDENSED CONSOLIDATING STATEMENT OF INCOME
For the Year Ended December 31, 2017

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
	(In thousands)				
Operating revenue	\$ —	\$ 635,604	\$ 40,509	\$ —	\$ 676,113
Operating expenses:					
Operations:					
Purchased water	—	198,682	399	—	199,081
Purchased power	—	21,021	7,841	—	28,862
Pump taxes	—	13,924	—	—	13,924
Administrative and general	—	83,163	10,163	—	93,326
Other operations	—	67,069	7,903	(524)	74,448
Maintenance	—	21,595	935	—	22,530
Depreciation and amortization	94	72,327	4,453	(91)	76,783
Income tax (benefit) expense	(498)	33,313	1,405	1,059	35,279
Property and other taxes	(4)	21,778	3,023	—	24,797
Total operating (income) expenses	(408)	532,872	36,122	444	569,030
Net operating income	408	102,732	4,387	(444)	107,083
Other Income and Expenses:					
Non-regulated revenue	1,985	14,608	1,814	(2,509)	15,898
Non-regulated expenses	—	(8,139)	(1,251)	—	(9,390)
Other components of net periodic benefit cost	—	(9,032)	(556)	—	(9,588)
Allowance for equity funds used during construction	—	3,750	—	—	3,750
Gain on sale of non-utility properties	—	663	—	—	663
Income tax expense on other income and expenses	(809)	(1,714)	(47)	1,022	(1,548)
Net other income (loss)	1,176	136	(40)	(1,487)	(215)
Interest:					
Interest expense	1,131	35,116	2,026	(1,985)	36,288
Allowance for borrowed funds used during construction	—	(2,319)	(41)	—	(2,360)
Net interest expense	1,131	32,797	1,985	(1,985)	33,928
Equity earnings of subsidiaries	72,487	—	—	(72,487)	—
Net income	\$ 72,940	\$ 70,071	\$ 2,362	\$ (72,433)	\$ 72,940

Affiliate Transaction Rules Applicable to Class A and B Water Utilities

RULE I. Jurisdiction and Applicability

I.A.

These Rules apply to all Class A and Class B California public utility water and sewer corporations or companies subject to regulation by the California Public Utilities Commission (Commission).

Cal Water Compliance: As a Class A water utility subject to Commission regulation, Cal Water affirms that these Rules apply to it and its employees. Cal Water has appropriate procedures and mechanisms to ensure compliance with these Rules in place. Cal Water's training materials and resources reference the respective compliance requirements associated with each rule.

I.B.

These Rules apply to transactions between a Commission-regulated utility and another affiliated entity that is engaged in the provision of products that use water or sewer services or the provision of services that relate to the use of water or sewer services, including the utility's parent company, and to the utility's use of regulated assets for non-tariffed utility services, unless specifically modified or exempted by the Commission. Transactions between a Commission-regulated utility and an affiliated utility regulated by a state regulatory commission (whether the utility is located in California or elsewhere) are exempt from these Rules, except for provisions of Rule IV.B and Rule X.

Cal Water Compliance: Cal Water affirms that these Rules apply to transactions with its covered affiliates as discussed below. Cal Water reserves the right to reclassify an affiliate, with appropriate notice to the Commission, as the activities of that affiliate dictate.

Regulated Affiliates: Rule I.B specifically exempts from certain Rules any transactions between the utility and "an affiliated utility regulated by a state commission."

Accordingly, transactions between Cal Water and the following affiliates are **exempt from all of the Rules, with the exception that the following rules still apply:**

- ❖ Rule IV.B – requires the proper allocation of common costs, and prohibits cross-subsidies with Cal Water ratepayers; and
 - ❖ Rule X – rules for any non-tariffed products and services provided by Cal Water.
- (1) **Exempt: Hawaii Water Service Company** – a regulated utility that provides service to water and wastewater customers on the islands of Maui and Hawaii.
 - (2) **Exempt: New Mexico Water Service Company** – a regulated utility that provides service to water and wastewater customers in New Mexico.
 - (3) **Exempt: Washington Water Service Company** – a regulated utility that provides domestic water service in Washington State.

Affiliates outside of California that do not substantially affect Cal Water’s operations or operating costs: Under Rule I.H, an affiliate that “operates entirely outside of California,” and whose “operations do not substantially affect the utility’s operations and the operating costs in California” are exempt two provisions in these Rules. Accordingly, transactions between Cal Water and the following affiliate are subject to all of the Rules, except that they are exempt from the following provisions:

- ❖ Rule III.B – identifies specific activities related to affiliates that Cal Water may not engage in, including: providing leads to affiliates; soliciting business for affiliates; acquiring information to provide to affiliates; sharing non-public reports on strategic business matters; asking customers to allow sharing of information that will only go to affiliates; appearing to speak on behalf of affiliates, and; representing that an affiliate will get preferential treatment from the utility due to the affiliate relationship.
 - ❖ Rule III.C – requires that any customer information, utility information, unused capacity, or unused supply that is provided to an affiliate also be offered to similarly-situated market participants in a timely, non-discriminatory manner.
- (1) **Limited exemption: HWS Utility Services (“HWSUS”)** – an unregulated company in Hawaii that provides unregulated waste and wastewater services. All Rules except Rules III.B and III.C apply to this affiliate.

Other Affiliates: all Rules apply to transactions with the following Cal Water affiliates.

- (1) **California Water Service Group (“CWS Group”)** – Cal Water’s holding company, and the parent company for all affiliates listed here.
- (2) **CWS Utility Services (“CWSUS”)**: an unregulated company that owns real property in California.

I.C.

Utilities shall comply with all applicable State and Federal statutes, laws and administrative regulations.

Cal Water Compliance: Cal Water affirms that it is in compliance with all applicable State and Federal statutes, laws, and administrative regulations to which it is subject.

I.D.

Existing Commission rules for each utility and its parent company continue to apply except to the extent they conflict with these Rules. In such cases, these Rules supersede prior rules and guidelines, provided that nothing herein shall preclude (1) the Commission from adopting other utility-specific guidelines; or (2) a utility or its parent company from adopting other utility-specific guidelines, with advance Commission approval through Decision or Resolution. In the case of ambiguity regarding whether a conflict exists, there shall be a rebuttable presumption that these Rules apply.

Cal Water Compliance: Cal Water affirms that existing Commission rules for Cal Water and CWS Group continue to apply except to the extent that they conflict with these Rules.