

Date of Hearing: April 11, 2018

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT

Cecilia Aguiar-Curry, Chair

AB 2339 (Gipson) – As Amended April 3, 2018

SUBJECT: Water utility service: sale of water utility property by a city.

SUMMARY: Allows, in limited circumstances, a city to sell its drinking water property without a majority election. Specifically, **this bill:**

- 1) Requires the city to determine that it is uneconomical and not in the public interest to own and operate the public utility, and requires all of the following requirements to be met:
 - a) The sale is not for less than fair market value;
 - b) The sale is approved by a four-fifths vote of the city's legislative body;
 - c) There are at least two water suppliers that provide drinking water to residents in the city prior to the sale;
 - d) The city has deferred maintenance for the public water system as determined based on industry standards and by an independent third party;
 - e) The receiving (purchasing) water system's service area borders the service area of the subsumed (selling public water system) water system;
 - f) The subsumed water system is a small community water system;
 - g) The subsumed water system's customers shall pay the same rates as customers of the receiving water system. The consolidation shall be economically feasible for the rate payers in the subsumed system, the rate payers notified of the first year rates, and any rate increases that will be phased in;
 - h) Consolidation of the water systems is technically and economically feasible;
 - i) The city shall not sell unless it considers oral and written protest at its second regularly scheduled meeting following adoption of a resolution, as specified, to sell the public utility, and shall allow 45 days for hearing protests. The city must state its intended use of the sale proceeds;
 - j) Notice of the sale may be given by including it in the agency's regular billing statement. Only one protest per parcel, filed by the owner or tenant can be counted as a protest. The city must maintain all written protests for a minimum of two years following the date of the hearing where written protests are considered;
 - k) The resolution must be published at least once in a daily newspaper published and circulated in the city, or if there is none, the city council shall choose a newspaper published in the county. The resolution must also be posted for not less than 10 days in at least three conspicuous places within the city;

- l) The sale is subject to a majority vote of voters voting on the issue if at least 25% of residents of the city protest the sale at a regularly scheduled meeting. If 50% or more protest the sale, the city shall not sell the utility until one year has passed. If the sale fails, the city must wait at least one year before attempting another sale; and,
 - m) The legislative body has adopted a resolution that all of the above provisions have been met.
- 2) Finds and declares that it is that policy of the state to consolidate small public water systems under certain conditions. Supports that policy declaration by characterizing the challenges of small water systems with meeting the state human right to water policy.

EXISTING LAW:

- 1) Allows a city to purchase, lease, receive, hold and enjoy real and personal property, and control and dispose of it for the common benefit. Allows a city or a city and county to own and sell any public utility that it owns, generally by a two-thirds vote of its legislative body and subsequently by a two-thirds vote of all voters voting at an election, to authorize the sale. Allows a city or a city and county owning a public utility for furnishing water service to sell the public utility with a majority vote of its legislative body and a majority vote of the electorate.
- 2) Defines a small community water system to mean a community water system that serves no more than 3,300 service connections or a yearlong population of no more than 10,000 persons.
- 3) Establishes a policy of the state that every human being has the right to safe, clean, affordable, and accessible water adequate for human consumption, cooking, and sanitary purposes.
- 4) Establishes a policy of the state that should be affected by the logical formation, consolidation, and operation of water systems.
- 5) Encourages consolidation of, and gives funding priority to, the consolidation of small community water systems that serve disadvantaged communities, under specified conditions.
- 6) Under specified conditions allows the State Water Resources Control Board to order the consolidation of a public water system or a state small water system within a disadvantaged community.
- 7) Limits the liability of any agency in the chain of distribution that delivers water to a consolidated water system.

FISCAL EFFECT: This bill is keyed fiscal.

COMMENTS:

- 1) **Compliance with Drinking Water Standards.** According to the State Water Resources Control Board (SWRCB), as of November 20, 2017, there are 329 water systems serving just under 500,000 people that are out of compliance with drinking water standards. The SWRCB data is not inclusive of all drinking water systems that are out of compliance with

drinking water standards in the state, but likely captures the majority of violations. The SWRCB's data does not include information on many of the systems that serve very small populations. This would indicate that the SWRCB data is a conservative estimate of all drinking water systems that are out of compliance with drinking water standards.

- 2) **Characterization of Systems that are Out of Compliance.** There are approximately 7,500 public water systems in the state, of which 3,300 are community water systems. A community water system is a public water system that serves at least 15 service connections used by yearlong residents, or regularly serves at least 25 yearlong residents. These water systems primarily serve cities, neighborhoods, schools and businesses. The SWRCB data primarily captures community water systems; of systems in the SWRCB data, 61% are very small systems serving populations of 25-500 people. Those very small systems represent 80% of all drinking water standard violations. The disproportionate number of violations occurring in small systems is due to small systems having a small rate base. The small rate base is more likely to cause struggles to pay for asset management necessary to maintain the system.
- 3) **Consolidation.** It is the policy of the state to encourage the consolidation of small water systems. In 2015, the SWRCB was given the authority to order consolidation of a public water system within a disadvantaged community, under specified conditions. In 2016, the SWRCB was given the authority to evaluate the ability of a proposed new public water system's ability to meet drinking water standards for the foreseeable future and to deny a permit if it is determined that the new public water system will not be sustainable into the future. In 1997, the Public Utilities Commission (PUC) was required to use fair market value when setting rates creating a greater incentive for PUC regulated water providers to consolidate. At a November 2017 joint workshop between the PUC and the SWRCB, the SWRCB reported that they sent out approximately 250 letters to small public water systems from September through November recommending consolidation.
- 4) **Bill Summary.** Current law requires a city to obtain a majority vote of its electorate before property owned by its public utility before it can be sold. This bill instead allows, in limited circumstances, a city to sell its drinking water property without an election. However, the city must first conduct protest proceedings similar to the method required by Proposition 218 (1996). A majority vote election is required if 25% of residents file a written or oral protest. This bill requires all property to be sold for fair market value and the city must declare for which the proceeds from the sale must be used. This bill is sponsored by the author.
- 5) **Author's Statement.** "Small municipal public water systems provide water for human consumption. California has thousands of these systems that vary considerably in size and quality. Providing safe, clean, and affordable drinking water can be particularly challenging for small public water systems (less than 3,300 customers) that lack the resources to fund basic capital costs, let alone the ongoing costs of maintenance, energy, treatment, and personnel needed to operate what are sometimes very complex systems.

"Small public water systems can overcome these challenges by consolidating with other systems to achieve economies of scale in providing water service. Consolidated water systems can share costs such as billing and operational personnel, the cost of new water sources, and can purchase time-saving equipment that neither system could afford to purchase alone because they can spread costs over a larger customer base.

“Although some cities may want to voluntarily consolidate their small water systems, there are barriers to consolidation. One of those barriers is existing law which requires a city-wide election to consolidate a municipal public water system. The cost of an election is prohibitive for many communities. This bill will therefore modify the election requirement and allow cities to sell and consolidate their public water system if the city determines that it is uneconomical and not in the public interest to own and operate the water system.”

- 6) **Role of this Bill in Consolidation.** This bill would allow for city-owned water systems serving less than 10,000 people to sell the system without first going to an election. The bill restricts the sale without a vote on the issue to when the city has met requirements to sell for not less than fair market value, there are at least two other water suppliers in the city, the system has deferred maintenance, the rate impacts on the existing water system customers will be limited, and there is a protest process that could trigger an election.

The SWRCB data indicates that there are approximately 90 city-owned systems that are small enough to be eligible for the option this bill would provide. Those systems would also have to meet all of the other requirements that the bill would put in place for the sale without a vote. Of the 90 systems, it is likely that only a small percentage would qualify for and then utilize the option to sell without an election that this bill would provide. Eleven of the systems are currently out of compliance with drinking water standards and would be the strongest candidates to use the option this legislation would provide, as well as systems that are likely to fall out of compliance.

- 7) **Protest Process vs. Election.** Both protest processes and elections are common practices for the general public to become involved in the local agency decision-making process. While elections are more common, protest proceedings are used in a number of ways to gauge a community’s support or opposition to a proposed local agency action. For instance, agencies are required to conduct protest proceedings when following Proposition 218’s rate setting process, and local agency formation commissions (LAFCOs) must hold a public protest hearing when making a change of organization, such as an annexation or agency consolidation. Nonetheless, there are some key differences between elections and protest. In this instance, elections require a minimum of 50% plus one of those that vote to approve the sale of public utility property. For example, if only 15% of 5,000 people vote, 376 people need to vote “no” in order to successfully oppose the sale of property. A protest process, on the other hand, requires 25% of the entire residency (one per parcel) to provide an oral or written protest to trigger an election and for the protest to be successful. Continuing this example, out of the same 5,000 people, in order to reach a protest of 25%, opponents would have to file 1,250 protests. While circumstances may differ in each property sale, there is likelihood that the proposed protest process in this bill makes it more difficult for opponents to stop the sale.
- 8) **Prior and Related Legislation.** SB 2111 (Beverly), Chapter 169, Statutes of 1996, allowed municipal corporations owning and operating a public utility for furnishing water to sell or transfer all or any part of the utility located inside its municipal boundaries to another public entity or utility, with a majority vote of the legislative board of the municipal corporation and a majority vote of the qualified voters of the municipality.

SB 1268 (Kelley), Chapter 675, Statutes of 1997, required the PUC, when establishing the rate base value for the distribution system of a public water system acquired by a water corporation, to use the standard of fair market value for rate setting purposes.

SB 88 (Committee on Budget), Chapter 27, Statutes of 2015, allowed for the SWRCB to order consolidation of a public water system or a small water system within a disadvantaged community, under specified conditions. Additionally, SB 88 limited the liability of any agency in the chain of distribution that delivers water to a consolidated water system.

AB 685 (Eng), Chapter 524, Statutes of 2012, established the human right to water policy that every human being has the right to safe, clean, affordable, and accessible water adequate for human consumption, cooking, and sanitary purposes.

SB 1263 (Wieckowski), Chapter 843, Statutes of 2016, required a person submitting an application for a permit for a proposed new public water system to first submit a preliminary technical report, with specified information, to the SWRCB at least six months before initiating construction of any water-related development. The bill also authorized the SWRCB to direct the applicant to engage in negotiations to receive services from existing water systems.

AB 272 (Gipson) of 2017 was substantially similar to this bill. AB 272 was held in Assembly Appropriations Committee.

9) **Arguments in Support.** Supporters argue that this bill will encourage the voluntary consolidation of small city systems into larger systems that have a higher technical, managerial, and financial capacity, ultimately improving water services for many Californians. Small systems often lack economies-of-scale and the necessary resources to finance improvements and the ongoing costs of operations, maintenance, treatment, and compliance. This bill removes a significant barrier to consolidation by eliminating the requirements for cost prohibitive elections.

10) **Arguments in Opposition.** None on file.

11) **Double-Referral.** This bill was heard by the Water, Parks, and Wildlife Committee on March 20, 2017, and passed with a 12-1 vote.

REGISTERED SUPPORT / OPPOSITION:

Support

California Water Association
California Water Service
Cities of El Monte, Montebello and Willows
San Gabriel Valley Water Company

Opposition

None on file

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