Date of Hearing: July 16, 2025

ASSEMBLY COMMITTEE ON UTILITIES AND ENERGY
Cottie Petrie-Norris, Chair
SB 473 (Padilla) – As Amended April 10, 2025

SENATE VOTE: 37-0

SUBJECT: Water corporations: demand elasticity: rates and surcharges

SUMMARY: Requires the CPUC to ensure that errors in estimates of demand elasticity or sales do not result in material overcollections or undercollections by water corporations, and that any changes to water service rates or implementation of surcharges do not result in revenues exceeding those approved by the CPUC.

EXISTING LAW:

1) Establishes and vests the CPUC with regulatory authority over water corporations. (Article XII of the California Constitution)

2) Requires all charges demanded or received by any public utility for any product or commodity furnished or any service rendered shall be just and reasonable. (Public Utilities Code § 451)

3) Requires the CPUC in establishing rates for water service to consider separate charges for costs associated with customer service, facilities, variable operating costs, or other components of the water service provided to water users. Requires the CPUC to consider, and permits the CPUC to authorize, a water corporation to establish programs, including rate designs, for achieving conservation of water and recovering the cost of these programs through the rates. (Public Utilities Code § 727.5)

4) Requires the CPUC to ensure that errors in estimates of demand elasticity or sales do not result in material overcollections or undercollections of electrical corporations. (Public Utilities Code §739.10)

FISCAL EFFECT: According to the Senate Committee on Appropriations, the CPUC estimates ongoing ratepayer-funded costs of approximately $576,000 annually to support review of requests from regulated water corporations related to decoupling mechanisms, recovery of revenue shortfalls through rate surcharges, and other related responsibilities.

BACKGROUND:

CPUC-Regulated Water Utilities – The CPUC regulates more than 100 investor-owned water and sewer utilities (IOUs) that provide water service to approximately 16% of California's residents**,** with combined annual revenues of about $1.4 billion.[1] Among these, roughly 95% of customers—nearly 1.2 million—are served by nine large water IOUs, known as Class A water

[1] CPUC, "Water Division"; https://www.cpuc.ca.gov/about-cpuc/divisions/water-division

utilities, each serving more than 10,000 service connections.[2] The CPUC ensures that water utility rates, services, and operations are just and reasonable by requiring Class A water utilities to submit a General Rate Case (GRC) every three years to justify any proposed rate changes.[3] These applications include historical expenses, infrastructure improvement projects, and forward-looking cost projections to justify proposed rate increases. The CPUC reviews the request and supporting documentation through a formal public process that includes opportunities for public comment, input from the Public Advocates Office, and evidentiary hearings.

Water rates for Class A utilities typically include two components:

- Service Charge (Fixed Charge): A recurring monthly or bi-monthly charge that helps recover up to 50% of the utility's fixed costs—expenses that do not vary based on customer usage. These typically include costs such as water quality testing, infrastructure maintenance, meter reading, billing, and customer service.

- Quantity Charge (Use Charge): A volumetric charge based on a customer's actual water consumption. Utilities apply a tiered rate structure that sets different prices per unit of water depending on the amount used—charging lower rates for lower levels of water usage and higher rates as usage increases. This structure is designed both to encourage conservation and to reflect the rising cost of supplying additional water.

Decoupling. Revenue decoupling is a ratemaking mechanism that allows an investor-owned utility (IOU) to recover its authorized revenue requirement regardless of how much volume of electricity or gas it sells, meaning a utility's earning is not affected by changes in customer usage. Instead the utility is allowed to recover a fixed, pre-approved amount of revenue set by the CPUC.

For background, in the aftermath of the 1970s energy crises—marked by fuel shortages and price shocks—California launched a broad effort to reduce energy consumption and improve efficiency. At the time, utilities operated under traditional cost-of-service regulation, which tied revenues directly to the volume of energy sold. As a result, when customers used less energy—due to conservation or efficiency programs—utilities collected less revenue, even though their fixed costs remained the same. This structure created a financial disincentive for utilities to promote conservation. To address this misalignment, the CPUC adopted the Supply Adjustment Mechanism (SAM) in 1978 for gas utilities.[4] SAM was the state's first decoupling mechanism, designed to stabilize utility revenues despite fluctuations in sales caused by weather, fuel switching, or conservation efforts. It worked by tracking the difference between a utility's authorized revenue and its actual revenue in a balancing account. Over-or under-collections were then refunded or recovered semi-annually through changes in rates. Building on this model, the CPUC adopted the Electric Revenue Adjustment Mechanism (ERAM) in 1982, extending

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[2] Class A water utilities serve more than 10,000 service connections. On a per-utility basis, the majority of the CPUC-regulated water utilities (92) have service connections of 2,000 customers or less, and 87 of those have service connections of 500 or less.
[3] CPUC; "What is a General Rate Case?" https://www.cpuc.ca.gov/about-cpuc/divisions/water-division/water-rates-and-general-rate-case-proceedings-section/general-rate-case-process?
[4] CPUC Decision 88835 established Supply Adjustment Mechanism (SAM), California's first revenue decoupling policy for gas utilities.

decoupling to investor-owned electric utilities.[5] By adopting ERAM, California became the first state to decouple utility revenues from electricity sales—removing the disincentive for utilities to support energy efficiency and conservation, while helping reduce reliance on costly new power plants. Over time, the concept of decoupling was extended to other utility sectors, including water, through mechanisms such as the Water Revenue Adjustment Mechanism (WRAM).

Water Revenue Adjustment Mechanisms (WRAMs). WRAMs are ratemaking mechanisms developed by the CPUC to incentivize Class A investor-owned water utilities (IOUs) to pursue water conservation. WRAM balances are not included in standard service or volumetric (per-unit) charges. Instead, they are tracked in a balancing account and recovered—or refunded—through a separate surcharge or credit on customer bills, based on the difference between actual and authorized revenues. The CPUC has instituted two types of WRAMs: full WRAM and Monterey-style WRAM:

i) Full WRAM: Utilities are required to forecast how much water their customers will use, and rates are set based on those projections to ensure the utility collects enough revenue to cover its authorized costs. However, actual water usage can vary significantly from these forecasts due to factors such as drought conditions, customer conservation, or unexpected economic changes—for example, periods of high inflation or sudden increases in water rates may prompt customers to reduce their water use, leading to deviations from pre-approved forecasts. Under a full WRAM, if actual water sales—and resulting revenue—fall below the forecast used to set rates, the utility is authorized to recover its full authorized revenue**.** The shortfall is captured in the WRAM balancing account and later recovered from customers via a surcharge. Similarly, if billed revenue exceeds forecasts, the difference is returned to customers as a credit**.**

ii) Monterey-style WRAM: Unlike Full WRAM, Monterey-style WRAM does not compare actual water sales to a forecast. Instead, it compares two different ways of calculating revenue based on the same volume of water sold. The first is the actual revenue collected under the adopted tiered rate structure, which charges lower rates for basic water use and higher rates for more water consumption. The second is the amount the utility would have collected if it had used a uniform rate—a single flat rate applied to all water use, regardless of how much a customer consumes. If actual revenue under the tiered structure is lower than the revenue that would have been collected under the uniform rate, the utility is authorized to recover the difference. The shortfall is captured in the WRAM balancing account and later recovered from customers through a surcharge. Similarly, if revenue under the tiered structure exceeds the uniform-rate equivalent, the difference is returned to customers as a credit.

CPUC full WRAM pilot program – The Full WRAM was first implemented in 2008 as part of a pilot program approved by the California Public Utilities Commission (CPUC) to promote water conservation while ensuring utilities could still recover their authorized revenue. The pilot was the result of settlement agreements between several Class A investor-owned water utilities and

[5] CPUC Decision 82-12-055 adopted the Electric Revenue Adjustment Mechanism (ERAM)

the CPUC's Public Advocates Office (PAO), which recognized that traditional rate structures created a disincentive for utilities to promote conservation efforts.

Under these settlements, Full WRAM mechanisms were adopted by California Water Service Company, California-American Water Company, Golden State Water Company, Liberty Utilities (Park Water) Corp., and Liberty Utilities (Apple Valley Ranchos Water) Corp. These mechanisms fully decouple a utility's revenue from actual water sales by allowing the recovery or refund of the difference between actual billed revenue and the CPUC-authorized revenue requirement—regardless of whether the shortfall results from conservation, weather or economic conditions. In contrast, San Jose Water Company and California-American Water's Monterey District operate under Monterey-style WRAMs. Rather than fully decoupling revenue from water sales, these mechanisms compare revenue collected under tiered rates to what would have been collected under a uniform, revenue-neutral rate—reflecting only the impact of the rate design on revenue **(**i.e., whether the utility earns more or less simply because of how rates are structured, not because customers used more or less water).

CPUC Eliminates Full WRAM – In 2020, the CPUC adopted Decision 20-08-047, which eliminated the use of full WRAMs for all Class A water utilities and allowed utilities to instead petition for a Monterey-style WRAM in their general rate cases. The decision marked the end of a 10-year pilot program intended to promote water conservation by decoupling utility revenues from sales. However, after reviewing the program results, the CPUC concluded that the full WRAMs did not produce the expected benefits. Notably, the CPUC found no clear evidence that utilities operating under full WRAMs conserved more water than those without decoupling mechanisms. The analysis suggested that conservation outcomes were comparable regardless of the revenue model. The decision also cited a range of issues stemming from the mechanism's structure, including increased rate volatility, large deferred balances, and customer confusion over bill surcharges. Furthermore, the CPUC noted that the full WRAM made it difficult to determine whether declines in water use were largely due to conservation efforts versus other factors such as weather patterns, economic conditions, drought, or inaccurate sales forecasts — limiting the ability to evaluate program effectiveness and ensure accountability.

In other words, the CPUC found that full WRAMs had the potential to create a perverse incentive for water utilities to inflate their sales forecasts. Because the mechanism guaranteed recovery of the difference between forecasted and actual revenues—regardless of the cause of that difference—utilities could benefit from setting sales forecasts higher than likely outcomes, knowing they would recover the difference through WRAM surcharges on customer bills. The CPUC concluded that eliminating full WRAMs would remove this incentive and encourage utilities to develop more accurate sales forecasts. By contrast, the CPUC maintained that Monterey-style WRAMs, which only adjust for revenue differences caused by the tiered rate design rather than total sales volume, continue to support conservation efforts while providing a narrower and more transparent form of revenue recovery.

In her dissent to Decision 20-08-047, then-Commissioner Liane Randolph acknowledged the shortcomings of both full and Monterey-style WRAMs. She noted that both mechanisms could incentivize utilities to project higher sales in rate cases to safeguard against undercollection. However, she cautioned that eliminating full WRAMs could lead water utilities to seek substantial rate increases upfront to compensate for the lost ability to recover revenue shortfalls through surcharges. Randolph expressed concern that this shift could shift financial risk to ratepayers in new ways, potentially resulting in higher fixed charges or steeper volumetric rates.

Nevertheless, the CPUC ultimately determined that the risks associated with the full WRAM—including rate volatility, reduced transparency, and difficulty assessing conservation outcomes—justified phasing it out in favor of the Monterey-style WRAM, which better supports transparency, accountability, and alignment between rates and the cost of providing service.

COMMENTS:

1) According to the author, "As California families face increasing economic pressures like rising costs and inflation, we must take every step to lower costs and address the affordability crisis in our communities. Water decoupling is proven to reduce water usage and keep utility rates affordable – exactly the kinds of solutions we need to deliver to Californians."

2) *Supreme Court Decision*. Following the CPUC's adoption of Decision 20-08-047 in 2020, which eliminated full WRAMs for Class A water utilities, several affected utilities—including Golden State Water Company—filed petitions for rehearing. Before the CPUC issued its rehearing decision, Golden State Water also filed a petition for writ of review with the California Supreme Court, challenging the procedural validity of the CPUC's action. The Court agreed to hold the case in abeyance pending the outcome of the CPUC's rehearing process. In September 2021, the CPUC denied the rehearing request in Decision 21-09-047, prompting Golden State and several other utilities to file amended or separate petitions. The Supreme Court consolidated the cases and on July 2024, issued its decision in *Golden State Water Co. v. Public Utilities Commission*. The Court set aside the CPUC's prohibition of full WRAMs on procedural grounds – not on the policy merits – because the CPUC did not provide adequate notice during the rulemaking process that eliminating WRAMs was under consideration.

   The Supreme Court reversed only the part of the CPUC's decision that categorically barred IOUs from requesting WRAMs in future proceedings. The Supreme Court also noted that this prohibition had effectively been rendered moot by SB 1469 (Bradford, Chapter 890, Statutes of 2022), which had already granted IOUs the statutory right to propose decoupling mechanisms—including full WRAMs—in their general rate cases. The legislation which took effect on January 1, 2023, clarified that the CPUC has discretion to approve or reject such mechanisms on a case-by-case basis.

3) *This Bill.* SB 473 would require the CPUC to provide water utilities with full decoupling revenue mechanisms. As stated earlier, under full decoupling, water utilities are guaranteed recovery of their authorized revenue, regardless of how much water they actually sell. While this approach is intended to remove the disincentive for utilities to support conservation, it also introduces other challenges—particularly related to forecasting discipline and ratepayer impacts.

   In a typical rate case, utilities are expected to submit data-driven forecasts of future water sales. These forecasts serve as the foundation for setting rates that will allow the utility to recover its authorized costs. However, full decoupling removes the financial consequences of inaccurate forecasts. If a utility overestimates its sales—whether intentionally or not—it can still recover its full revenue through surcharges on customers, even if actual consumption is significantly lower than projected. This structure creates a

potential perverse incentive to inflate sales forecasts, knowing that any shortfall will ultimately be covered by ratepayers through the WRAM balancing account.

The CPUC, in its 2020 decision to phase out full WRAMs, raised the same concern. It found that full decoupling had not led to measurable conservation benefits compared to utilities without WRAMs, and instead had resulted in large balancing account surcharges, reduced transparency and regulatory accountability. These outcomes not only confused customers—who faced unpredictable adjustments on their bills—but also undermined the integrity of the rate-setting process by shifting financial risk away from utilities and onto the very customers the mechanism was intended to protect.

Without additional safeguards to ensure forecasting accuracy and customer protections, this measure may unintentionally reintroduce the very problems that led the CPUC to eliminate full WRAMs in the first place.

4) *Prior Legislation.*

SB 1469 (Bradford) required the CPUC to consider whether to authorize, upon application by a water corporation, implementation of a utility rate mechanism that separates a water corporation's revenues and its water sales, commonly referred to as a "decoupling mechanism." Status: Chapter 890, Statutes of 2022.

AB 29 (Kehoe) among its many provisions related to energy, included explicit language to decouple electricity sales with revenue recovery for electrical corporations. Status: Chapter 8, First Extraordinary Session of 2001.

AB 2815 (Moore) authorized the CPUC, in establishing rates for water service, to establish separate charges for costs associated with customer service, facilities, and fixed and variable operating costs, as specified. Status: Chapter 549, Statutes of 1992.

REGISTERED SUPPORT / OPPOSITION:

Support

Alliance for Water Efficiency
Bay Area Council
Butte Environmental Council
Calasian Chamber of Commerce
California African American Chamber of Commerce
California Alliance for Jobs
California American Water
California Chamber of Commerce
California Hawaii State Conference of the NAACP
California Hispanic Chambers of Commerce
California Pacific Asian Chamber of Commerce (calasian Chamber)
California State Pipe Trades Council
California Water Association
California Water Service
California-hawaii State Conference of the NAACP

Carson Chamber of Commerce
City of Thousand Oaks
Commerce Business Council Chamber of Commerce
Cupertino Chamber of Commerce
East Bay Leadership Council
East Los Angeles Chamber of Commerce
El Concilio California
Golden State Water Company
Hawthorne Chamber of Commerce
Hermosa Beach Chamber of Commerce
Icon CDC
Initiating Change in Our Neighborhoods Community Development Corporation Icon CDC
International Association of Plumbing & Mechanical Officials
International Union of Operating Engineers Local 3
League of California Cities
Long Beach Area Chamber of Commerce
National Association of Water Companies
Office of Monterey County Supervisor Chris Lopez
Palos Verdes Peninsula Chamber of Commerce
Regional Water Authority
Sacramento Metro Chamber of Commerce
Sacramento Metropolitan Chamber of Commerce
San Jose Chamber of Commerce
San Jose Water Company
Santa Clara & San Benito Building and Construction Trades Council
Sierra Nevada Alliance
Silicon Valley Leadership Group
Southern California Water Coalition
Torrance Area Chamber of Commerce
Utility Workers Union of America Local 259
Water Replenishment District
West Basin Water Association

Opposition

Monterey Peninsula Water Management District
Public Advocates Office
Public Water Now

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