

CALIFORNIA-AMERICAN WATER
COMPANY

COMPLIANCE EXAMINATION

2019 – 2020

AFFILIATE TRANSACTION RULES



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INDEPENDENT ACCOUNTANT'S REPORT

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We have examined California-American Water Company's ("California American Water" or "Utility") compliance with the *Modified Rules for Water and Sewer Utilities Regarding Affiliate Transactions and the Use of Regulated Assets for Non-Tariffed Utility Services* ("the Rules"). California-American Water Company's management is responsible for the compliance with those requirements. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants in addition to Generally Accepted Government Auditing Standards (GAGAS) and, accordingly, included examining, on a test basis, evidence supporting California-American Water Company's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether California-American Water Company is in accordance with the Rules, in all material respects. An examination involves performing procedures to obtain evidence about the compliance of the Rules. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

In our opinion, California-American Water Company complied, in all material respects, with the requirements under the Rules for the period January 1, 2019 through December 31, 2020.

This report is intended solely for the information and use of management of California-American Water Company and the California Public Utilities Commission and is not intended to be and should not be used by anyone other than these specified parties.

Sotomayor & Associates, LLP
Pasadena, CA

July 28, 2021

Registered with the Public Companies Accounting Oversight Board, member of the American Institute of Certified Public Accountants, CPCA Section, the California Society of Certified Public Accountants, and the New Jersey Society of Certified Public Accountants

Executive Summary

The audit performed examined California-American Water Company's ("California American Water") compliance with the California Public Utilities Commission's ("Commission") directives regarding its Rules for Water and Sewer Utilities Regarding Affiliate Transactions and the Use of Regulated Assets for Non-Tariffed Utility Services ("Rules"). Our examination found that California American Water complied with all Rules.

This audit also included, at the request of California American Water, a procedure to verify if any transactions have occurred between California American Water and BlackRock, Inc. during the audit period. The details of this procedure are described in Appendix B.

In addition, at the request of California American Water, the same procedure was performed to verify if any transactions have occurred between California American Water and The Vanguard Group during the audit period. The details of this procedure are described in Appendix C.

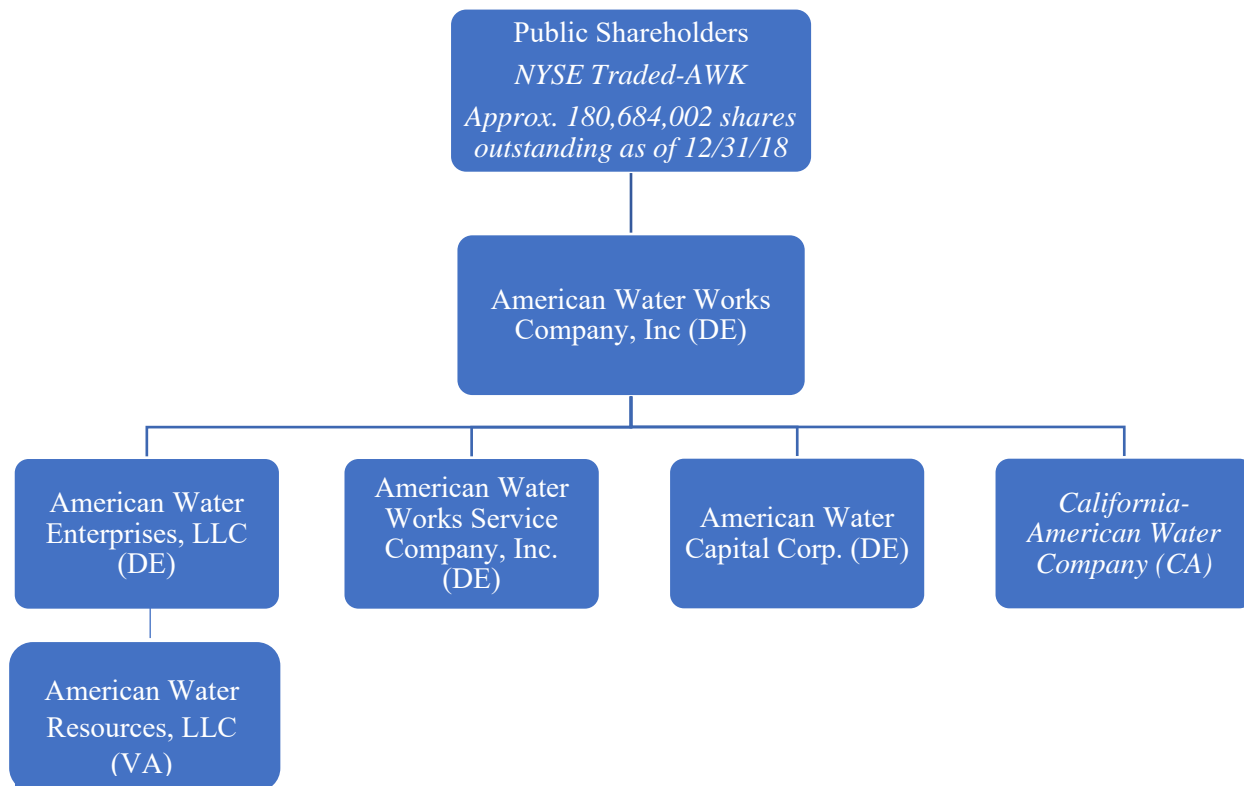
Background

In October of 2010, the Commission adopted Decision ("D.") 10-10-019, which provided Class A and B water utilities with a set of rules governing affiliate transactions and the provision of non-tariffed products and services. Beforehand some water utilities were operating under Commission affiliate transaction rules designed primarily for the establishment of holding companies. The Commission adopted the Rules to provide "consistent and understandable rules for all subject water and sewer utilities". The Commission further stated that "our newly adopted rules address our goals of protecting ratepayers, ensuring the financial health of the utility, and preventing anti-competitive behavior in the competitive marketplace".

The Rules went into effect on June 30, 2011. Rules V.C and V.D subsequently went into effect on November 30, 2011. Under the Rules, biennial independent audits are required, with the fourth audit for the period from January 1, 2017 to December 31, 2018 due to the Commission by September 30, 2019. The fifth audit will be for years ending December 31, 2019 and 2020, which will be due to the Commission on September 30, 2021.

California American Water is wholly owned by its parent company, American Water Works Company, Inc. ("AWWC"). AWWC also owns multiple other regulated water utilities operating in states outside of California, as well as non-regulated companies such as American Water Enterprises, LLC ("AWE"), which, among other things, provides water and sewer operation and maintenance contract services. AWE owns American Water Resources, LLC ("AWR"), which provides water and sewer line protection programs in multiple states, including California. Corporate support services are provided at cost to California American Water by its non-regulated affiliate, American Water Works Service Company, Inc. ("Service Company") which is also wholly owned by AWWC.

Below is a condensed organizational chart that reflects the main companies involved with this examination:



After adoption of the Rules, but prior to their implementation, California American Water took numerous steps to help ensure compliance with the Rules. For example, California American Water established an Affiliate Transaction Rules Compliance Committee (“ATRCC”) and an Affiliate Transaction Rules Executive Committee (“ATREC”).

The ATRCC is responsible for overall compliance and interpretation of the Rules and their application to particular transactions. The ATRCC was established to provide education, direction and oversight of all matters pertaining to training and implementation of the Rules. The compliance tools that the ATRCC uses include: employee communications and education/training; issuance of procedures governing affiliate transactions and reporting requirements; and ongoing monitoring necessary to comply with the Rules. The members of the ATRCC include representatives from each of the major functions of California American Water, including Operations, Engineering, Human Resources, Legal and Finance. The members of the ATRCC also include representatives from the Service Company, including the Call Center and Accounting.

The ATRCC reports to the ATREC, which was established to provide oversight and guidance to the ATRCC. The members of the ATREC include senior management of California American Water as well as a senior management representative of the Service Company.

Also, prior to implementation of the Rules, California American Water provided training to California American Water and affiliate employees. California American Water provided on-site employee training in each of its Districts as well as web-based training to out-of-state affiliate employees. California American Water continued to provide training to California American Water and affiliate employees, including Call Center employees, after implementation of the Rules, and during the audit period, California American Water issued Affiliate Transaction Procedures, which are updated quarterly, to assist employees in understanding the Rules.

Audit Purpose and Objective

Rule VIII.E requires the utility to engage an independent auditor if a certain threshold is met, to verify that the utility is in compliance with the Rules. The purpose of this audit is to comply with this requirement. The fifth audit report is due by September 30, 2021.

Audit Scope and Methodology

The audit period covered by this audit is January 1, 2019 through December 31, 2020. The fieldwork consisted of interviews, research, data analysis, observations and sample testing, conducted through telephone and virtually with to the California American Water headquarters in San Diego, CA, the operations in Alton, IL and the Service Company in Camden, NJ between March 11, 2021 and July 27, 2021. Appendix A describes the audit methodology used to determine California American Water's compliance with each Rule.

Audit Findings and Conclusions

Appendix A details the findings and conclusions for each Rule, which consists of sub-rules that provide the specific criteria. In response to Rule VIII.C, California American Water prepares a biennial compliance plan, which describes their comprehensive procedures to help ensure compliance with the Rules. We have provided California American Water's 2021 Compliance Plan dated June 1, 2021 as the criteria for each sub-rule, followed by Sotomayor's conclusions and comments.

Appendix B details the additional procedures performed, and conclusion reached regarding the existence of transactions between California American Water and BlackRock, Inc.

Appendix C details the additional procedures performed, and conclusion reached regarding the existence of transactions between California American Water and The Vanguard Group.

Appendix A – Audit Methodology, Findings, and Conclusions

RULE I – Jurisdiction and Applicability

Rule 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).

California American Water Compliance: As a Class A water utility subject to Commission regulation, California American Water affirms that these Rules apply to it and its employees. California American Water has implemented and will continue to implement appropriate procedures and mechanisms as needed to help ensure compliance with these Rules. Further, California American Water’s training materials and resources will reference the respective compliance requirements associated with each rule (as applicable).

Sotomayor Conclusion: California American Water serves greater than 10,000 customers and is therefore classified as a Class A Utility.

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.

California American Water Compliance: California American Water affirms that the Rules apply to transactions with its covered affiliates, as defined in Rule I.B. California American Water has implemented and will continue to implement appropriate procedures and mechanisms to help ensure compliance with the applicability provisions of Rule I.B. Appendix A contains a list of all affiliates of California American Water, as defined in Rule II.E, and for each affiliate a description of its purposes or activities, and the applicability of the Rules to the affiliates. California American Water reserves the right to reclassify an affiliate as the activities of that affiliate dictate.

Sotomayor Conclusion: California American Water is in compliance with Rule I.B. During the examination, we performed observations and inquiries of California American Water management. We also reviewed the organizational chart for California American Water and the American Water Works Company, Inc. (American Water) as a whole to understand the structure of the related affiliates, including the regulated affiliates and the “Covered Affiliates”. Transactions with covered affiliates mainly include transactions with the following affiliates: American Water Capital Corp., American Water Works Service Company, Inc. (Service Company), American Water Enterprises, LLC (AWE), and American Water Resources, LLC (AWR). Based on our review of the rules and discussions with California American Water management, it was determined that the Rules apply to California American Water’s transactions

with these affiliates. Regulated businesses would be regulated by the respective utilities commission governing the state in which each does business.

Rule I.C. – Utilities shall comply with all applicable State and Federal statutes, laws and administrative regulations.

California American Water Compliance: California American Water affirms that it will comply with all applicable State and Federal statutes, laws and administrative regulations to which it is subject.

Sotomayor Conclusion: California American Water’s Internal Audit Department has reported no serious deficiencies. We reviewed the annual financial audits conducted by their Independent Registered Public Accounting Firm for 2019 and 2020 and found that each year it received an unqualified opinion that the financial statements presented fairly the financial position of the company. Additionally, we confirmed through multiple observations and interviews that California American Water’s statement of compliance with Rule I.C is accurate.

Rule 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.

California American Water Compliance: California American Water interprets this Rule and Rule I.E to mean that an affiliate rule existing at the time the Rules were adopted is superseded if the subject matter of that rule is addressed by the Rules. As such, California American Water believes that all of its previously existing affiliate rules (established in D.02-12-068) were superseded as of June 30, 2011.

Sotomayor Conclusion: Based on the review of California American Water’s existing rules, Appendix B in the 2021 compliance plan, and after review of the Rules as of June 30, 2011, it has been determined that California American Water’s interpretation of the Rules is correct. The existing California American Water rules appear to be superseded by the Rules, in effect as of June 30, 2011.

Rule I.E. – Where these Rules do not address an item currently addressed in a utility’s existing rules imposed by this Commission, which govern that utility’s transactions with its affiliate(s) or its use of regulated assets for non-tariffed utility services, the existing utility-specific rules continue to apply for that item only.

California American Water Compliance: California American Water interprets this Rule and Rule I.D to mean that an affiliate rule existing at the time the Rules were adopted is superseded if the subject matter of that rule is addressed by the Rules. As such, California American Water believes

that all of its previously existing affiliate rules (established in D.02-12-068) were superseded as of June 30, 2011.

Sotomayor Conclusion: Based on the review of California American Water's existing rules, Appendix B of California American Water's Compliance Plan dated June 1, 2021, and after review of the Rules, it has been determined that California American Water's interpretation of the Rules is correct. The existing California American Water rules appear to be superseded by the Rules, in effect as of June 30, 2011.

Rule I.F. – These Rules do not preclude or stay any form of civil relief, or rights or defenses thereto, that may be available under state or federal law.

California American Water Compliance: California American Water affirms the Commission's intent that the Rules do not preclude or stay any form of civil relief, or rights or defenses thereto, that may be available under state or federal law.

Sotomayor Conclusion: Based on our observations and testing, California American Water affirms this Rule and is in compliance.

Rule I.G. – A California utility that is also a multi-state utility and subject to the jurisdiction of other state regulatory commissions, may file an application with this Commission, served on all parties to this proceeding and its most recent general rate case, requesting a limited exemption from these Rules or a part thereof, for transactions between the utility solely in its capacity serving its jurisdictional areas wholly outside of California, and its affiliates if such out-of-state operations do not substantially affect the utility's operations and the operating costs inside California. The applicant has the burden of proof.

California American Water Compliance: Rule I.G does not apply to California American Water because California American Water does not operate outside of the State of California.

Sotomayor Conclusion: Based on our observations and inquiries, Rule I.G. does not apply to California American Water since it only operates as a regulated utility within the state of California.

Rule I.H. - A California utility's affiliates that operate entirely outside of California are exempt from Rule III.B and Rule III.C of these Rules, for transactions between the utility and such affiliates, if the affiliates' operations do not substantially affect the utility's operations and the operating costs inside California.

California American Water Compliance: The affiliates of California American Water listed as Classification 4 in Appendix A operate entirely outside of California and their operations do not substantially affect California American Water's operations and the operating costs inside California. Therefore, the affiliates so listed in Appendix A are exempt from Rules III.B and III.C. The list of such exempt affiliates in Appendix A excludes affiliates that under Rule I.B are otherwise exempt from Rules III.B and III.C because they: 1) are not 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; or 2) are regulated by a state regulatory commission. California American Water reserves the right to reclassify an affiliate as the activities of that affiliate dictate.

Sotomayor Conclusion: Based on our observations and inquiries, the listed affiliates do not operate within California and, therefore, their operations do not substantially affect California American Water's costs within the state of California.

Rule I.I. – These Rules shall be interpreted broadly, to effectuate the Commission's stated objectives of protecting consumer and ratepayer interests and, as an element thereof, preventing anti-competitive conduct.

California American Water Compliance: California American Water affirms the Commission's intent that the Rules should be broadly interpreted.

Sotomayor Conclusion: California American Water affirms this Rule. Based on our observations and inquiries with multiple levels of personnel, it was determined that California American Water has affirmed to this Rule.

RULE II – Definitions

II.A. "Parent company" or "parent"

"Parent company" or "parent" is the entity, including a holding company or corporation, that owns, or has substantial operational control (as defined in Rule II.E) of, the regulated utility.

II.B. "Utility"

"Utility" (unless specified as a water utility) refers to all water utilities and sewer utilities regulated by the Commission.

II.C. "Water utility"

"Water utility" refers to all water utilities regulated by the Commission.

II.D. "Sewer utility"

"Sewer utility" refers to all sewer utilities regulated by the Commission.

II.E. "Affiliate"

"Affiliate" means any entity whose outstanding voting securities are more than 10 percent owned, controlled, directly or indirectly, by a utility, by its parent company, or by any subsidiary of either that exerts substantial operational control.

For purposes of these Rules, "substantial operational control" includes, but is not limited to, the possession, directly or indirectly of the authority to direct or cause the direction of the management or policies of a company. A direct or indirect voting interest of more than 10 percent by the utility in an entity's company creates a rebuttable presumption of substantial operational control.

For purposes of these Rules “affiliate” includes the utility’s parent company, or any company that directly or indirectly owns, controls, or holds the power to vote more than 10 percent of the outstanding voting securities of a utility or its parent company.

Regulated subsidiaries of a utility, the revenues and expenses of which are subject to regulation by the Commission and are included by the Commission in establishing rates for the utility, are not included within the definition of affiliate for the purpose of these Rules. However, these Rules apply to all interactions any such regulated subsidiary has with other affiliated unregulated entities covered by these Rules.

For the purposes of this Rule, “affiliate” shall not include a mutual water company, a joint powers authority, other governmental or quasi-governmental agency or authority, a public/private partnership, a watermaster board, a water basin association, or a groundwater management authority in which a utility participates or in which a utility is a member or shareholder.

II.F. “Costs”

“Costs” are used in these Rules to refer to the total expenses assigned or allocated to different projects or activities through the utility’s and parent company’s accounting systems. Cost categories include:

1. **Direct Costs.** Direct costs are costs that can be clearly identified to specific projects or activities because the resource in question, or some measurable portion of that resource, has been dedicated to the project or activity. An example would be the hours of a worker’s time spent on the effort, materials purchased and used specifically on that effort, or the proportion of a machine’s hours dedicated to the effort.
2. **Direct Overhead Costs.** For organizations that produce multiple outputs, direct overhead costs are the common costs of a subset of the organization, such as supervisors and support staff of a division not assigned or traceable to specific projects, or machinery shared among a subset of the company’s projects. Such overhead costs require allocation to specific projects through proxies and methodologies designed to accurately reflect the particular production aspects of each project; e.g., some processes are more capital-intensive than others and need less supervision input. Allocation methodologies for direct overhead costs can make use of several factors, often activity-based and often using “cost causation” as one of the principles in their design.
3. **Indirect Overhead Costs.** Indirect overhead costs are functions that affect the entire organization, such as the headquarters building, the Chief Executive Officer and Chief Financial Officer, General Counsel and associated legal support, personnel departments, security for this building or these offices, shareholder and public relations, insurance, depreciation, advertising, and similar functions. These are real costs of the organization and must be allocated to the ongoing projects and activities to determine the total cost of each. These are also sometimes called “General Overhead Costs.”

As of the date of this 2019 Plan, Chief Executive Officer costs of California American Water's parent company are not allocated to California American Water.

4. Fully-loaded (also known as fully-allocated) costs. Fully-loaded (or fully-allocated) costs refer to the total cost of a project or activity, which is the sum of Direct, Direct Overhead, and Indirect Overhead costs, as defined in Rule II.F.1, 2 and 3.

II.G. "Transaction"

"Transaction" means any transfer of an item of value such as a good, service, information or money between a utility and one or more of its affiliates.

II.H. "Property"

"Property" refers to any right or asset, tangible or intangible, to which an entity has legal or equitable title.

II.I. "Real Property"

"Real property" refers to any interest in real estate including leases, easements, and water rights.

II.J. "Customer"

"Customer" means any person, firm, association, corporation or governmental agency supplied or entitled to be supplied with water, wastewater, or sewer service for compensation by a utility.

II.K. "Customer information"

"Customer information" means non-public information and data specific to a utility customer which the utility acquired or developed in the course of its provision of utility services.

II.L. "Cross-subsidy"

"Cross-subsidy" means the unauthorized over-allocation of costs to captive ratepayers resulting in under-allocation of costs to a utility affiliate.

California American Water Compliance: California American Water will apply these definitions in the administration of its compliance with the Rules.

Sotomayor Conclusion: California American Water implements and consistently applies these definitions in the California American Water "Affiliate Transaction Rules Compliance Plan" and "Affiliate Transactions Procedures" and includes the relevant definitions in the California American Water Affiliate Transaction Rules training.

RULE III – Utility Operations and Service Quality

III.A. A utility shall not allow transactions with affiliates to diminish water utility staffing, resources, or activities in a manner that would result in degradation of the reliability, efficiency, adequacy, or cost of utility service or an adverse impact on customer service. Utility management attention shall not be diverted to such transactions in a way that would result in such degradation. The utility's parent and affiliates shall not acquire utility assets at any price if such transfer of

assets would impair the utility's ability to fulfill its obligation to serve or to operate in a prudent and efficient manner.

California American Water Compliance: California American Water provides training and issues periodic communications to its employees educating them on the requirements of the Rules.

Sotomayor Conclusion: Based on observations and interviews with multiple levels of personnel, it was noted that other than corporate shared services provided by the Service Company, California American Water and all affiliate companies are maintained and managed as separate entities. There is no degradation of utility service or impact to customer service related to the affiliates. Based on transaction testing, there were no transfers of assets from California American Water to its affiliates.

III.B. – Except as otherwise provided by these Rules, a utility shall not

1. Provide leads to its affiliates;

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule III.B.1.

California American Water provides training and issues periodic communications to its employees educating them on the requirements of the Rules.

California American Water interprets this Rule to not prohibit affiliates from providing leads to California American Water, especially with respect to potential acquisitions of water or sewer systems that may ultimately be regulated by the Commission.

California American Water further interprets this Rule to mean that a utility advising its parent (which is an affiliate under the current definition) of a potential purchase of a water or sewer system is not considered to be providing a lead if California American Water, not the parent company, will be making the purchase.

2. Solicit business on behalf of its affiliates;

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule III.B.2. California American Water provides training and issues periodic communications to its employees educating them on the requirements of the Rules.

3. Acquire information on behalf of or to provide to its affiliates;

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule III.B.3. California American Water provides training and issues periodic communications to its employees educating them on the requirements of the Rules.

California American Water interprets this Rule to exclude information exchanged with its parent company regarding potential purchases of water or sewer systems. In addition, California American Water interprets this rule to exclude sharing of such information for the purposes of corporate support, shared services and access to capital which are expressly permitted by Rule V.B.

4. Share market analysis reports or any other types of proprietary or non-publicly available reports, including but not limited to market, forecast, planning or strategic reports, with its affiliates, except that a utility may share such information with a parent under the condition that the parent does not share the information with any other entity;

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule III.B.4. California American Water provides training and issues periodic communications to its employees educating them on the requirements of the Rules.

California American Water interprets this Rule to exclude any information that an employee might otherwise legally disclose to others after termination of employment. Further, sharing of such reports for the purposes of corporate support, shared services and access to capital are expressly permitted by Rule V.B.

5. Request authorization from its customers to pass on customer information exclusively to its affiliates;

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule III.B.5. California American Water provides training and issues periodic communications to its employees educating them on the requirements of the Rules.

6. Give the appearance that the utility speaks on behalf of its affiliates; or

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule III.B.6. California American Water provides training and issues periodic communications to its employees educating them on the requirements of the Rules.

7. Represent that, as a result of the affiliation with the utility, its affiliates or customers of its affiliates will receive any different treatment by the utility than the treatment the utility provides to other, unaffiliated companies or their customers.

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule III.B.7. California American Water provides training and issues periodic communications to its employees educating them on the requirements of the Rules.

8. Provisions 3, 4 and 5 of Rule III.B shall not apply to utility affiliates that are non-profit and whose sole purpose is to serve the functions of regulated utilities, the parents of regulated utilities, governmental or non-profit entities, including non-profit affiliates of regulated utilities.

California American Water Compliance: California American Water acknowledges the exceptions provided for in Rule III.B.8. Further, in accordance with Advice Letter 1112 filed with the Commission on February 8, 2016, provision 3, 4, and 5 of Rule III.B do not apply to California American Water transactions with AWI, Inc.

9. Utilities may file an Advice Letter seeking an exemption to Rule III.B.8 within ninety days of the effective date of the Commission decision adopting these rules, requesting that a non-profit affiliate subject to Rule III.B.8 be allowed to serve the functions of other affiliates, as long as those other affiliates provide no more than five per cent of the annual revenues of the non-profit affiliate.

California American Water Compliance: California American Water filed Advice Letter 879 requesting the exemption authorized by this Rule for American Water Works Service Company, Inc. ("Service Company"). The Advice Letter became effective on March 11, 2011. Therefore, provisions 3, 4, and 5 of Rule III.B do not apply to the Service Company.

Sotomayor Conclusion: Based on observations and interviews of employees throughout the organization including California American Water and the Service Company, review of training materials and procedures, the Company appears to be in compliance with all elements of Rule III.B. Based on observations and interviews with multiple levels of personnel, and documentation obtained, it was determined that provisions 3, 4 and 5 of Rule III.B do not apply to the Service Company.

III.C. – Except as provided for elsewhere in these rules, if a utility provides customer or utility information, services, or unused capacity or supply to an affiliate, it must offer such customer or utility information, services, or unused capacity or supply to all similarly situated market participants in a non-discriminatory manner, which includes offering on a timely basis.

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule III.C. California American Water provides training and issue periodic communications to its employees educating them on the requirements of the Rules. Further, if California American Water offers customer or utility information, services or unused capacity or supply to an affiliate in a transaction governed by this Rule, California American Water will make such information available to all similarly situated market participants in a posting on California American Water's web site.

Sotomayor Conclusion: Based on observations and interviews with multiple levels of personnel, and documentation obtained, it was noted that California American Water does not provide customer or utility information, services, unused capacity or supply to its affiliates except as provided for elsewhere in the Rules. California American Water provides information to the Service Company for shared corporate services as authorized by the Rules.

RULE IV – Separation

Rule IV.A. – The utility shall maintain accounting records in accordance with Generally Accepted Accounting Principles, the Commission’s Uniform System of Accounts, Commission decisions and resolutions, and the Public Utilities Code.

California American Water Compliance: California American Water affirms that it maintains its accounting records in accordance with Generally Accepted Accounting Principles, the Commission’s Uniform System of Accounts, relevant Commission decisions and resolutions, and that its accounting records are consistent with the provisions in Public Utilities Code Sections 314 and 701.

Sotomayor Conclusion: Review of the audited annual financial reports confirmed that Generally Accepted Accounting Principles were applied. We also reviewed the Commission’s Uniform System of Accounts and California American Water’s Chart of Accounts and confirmed that California American Water uses the Commission’s Uniform System of Accounts.

Rule IV.B. – The utility, its parent and other affiliated companies shall allocate common costs among them in such a manner that the ratepayers of the utility shall not subsidize any parent or other affiliate of the utility.

California American Water Compliance: California American Water affirms that it has adequate procedures, mechanisms or policies in place to comply with Rule IV.B. California American Water will apply the definitions in Rule II.F to comply with Rule IV.B. California American Water will apply the definitions in Rule II.E. to comply with Rule IV.B. All such costs are reviewed and approved in each of California American Water’s general rate cases.

Sotomayor Conclusion: By reviewing account records and Commission guidance for charging common costs to affiliates, it was determined that California American Water maintains an adequate method for allocating common costs. An understanding of the cost allocation processes used was obtained and sample testing was performed to ensure processes were in place to allocate common costs in accordance with this Rule.

Rule IV.C. – The utility shall list all shared directors and officers between the utility and its affiliates in its annual report to the Commission. Not later than 30 days following a change to this list, the utility shall notify the Director of the Division of Water and Audits and the Director of the Division of Ratepayer Advocates of the change(s).

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule IV.C. California American Water will provide a list of all shared directors and officers between the utility and its affiliates in its annual reports to the Commission.

Sotomayor Conclusion: During the examination, the listings of shared directors and officers and Commission filings were obtained to test for compliance. Based on this documentation and

conversations with management, it was determined that California American Water provided the Commission with a listing of shared directors and officers within the 30-day timeframe.

Rule IV.D. – Employees transferred or temporarily assigned from the utility to an affiliate shall not use non-public, proprietary utility information gained from the utility in a discriminatory or exclusive fashion to the benefit of the affiliate to the detriment of unaffiliated competitors.

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule IV.D. California American Water will provide training and/or documentation to employees transferred or temporarily assigned to affiliates covered by this Rule.

Sotomayor Conclusion: During the examination, multiple interviews of California American Water and Service Company employees were conducted, training materials were reviewed, and training completion report were obtained. Training has emphasized the importance of not sharing propriety information. Employees have a firm understanding of this Rule.

Rule IV.E. – All employee movement between a utility and its affiliates, as defined in Rule I.B, shall be consistent with the following provisions:

Rule IV.E.1 – A utility shall track and report to the Commission all employee movement between the utility and affiliates, consistent with Rule VIII.F.

California American Water Compliance: California American Water interprets this Rule as being applicable to permanent movement only (as opposed to temporary or intermittent use under Rule IV.E.3) and has implemented procedures and mechanisms to comply with Rule IV.E.1. California American Water includes this information in its annual reports to the Commission.

Sotomayor Conclusion: During the examination, documentation was obtained to validate the employee transfers noted on the Annual Reports of Affiliate Transactions. There were two employees transferred from American Service Company to CAW in 2019. There were three employees transferred from affiliated companies to CAW in 2020; one employee transferred from Indiana American Water and two employees from American Water Service Company. We reviewed and examined the documentation of all employee movements. The records were consistent with the reporting to the Commission. Therefore, California American Water is in compliance with Rule IV.E.1.

Rule IV.E.2 – When an employee of a utility is transferred, assigned, or otherwise employed by the affiliate, the affiliate shall make a one-time payment to the utility in an amount equivalent to 15% of the employee's base annual compensation. All such fees paid to the utility shall be accounted for in a separate memorandum account to track them for future ratemaking treatment on an annual basis, or as otherwise necessary to ensure that the utility's ratepayers receive the fees. This transfer payment provision does not apply to clerical workers.

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule IV.E.2. Separate memorandum accounts were established to track any such fees via Advice Letter 910 (water service) and Advice Letter 18 (sewer service).

Sotomayor Conclusion: During the examination, there were five employee transfers from affiliated companies to CAW. 15% of the employee's base annual compensation is not applicable to the employee who transfer from affiliated companies. Therefore, California American Water complied with Rule IV.E.2.

Rule IV.E.3 – Utility employees may be used on a temporary or intermittent basis (less than 30% of an employee's chargeable time in any calendar year) by affiliates only if:

- a. All such use is documented, priced and reported in accordance with these Rules and existing Commission reporting requirements, except that when the affiliate obtains the services of a non-executive employee, compensation to the utility shall be priced at a minimum of the greater of fully loaded cost plus 5% of direct labor cost, or fair market values. When the affiliate obtains the services of an executive employee, compensation to the utility shall be priced at a minimum of the greater of fully loaded cost plus 15% of direct labor cost, or fair market value;
- b. Utility needs for utility employees always take priority over any affiliate requests;
- c. No more than 10% of full time equivalent utility employees may be on loan at a given time;
- d. Utility employees agree, in writing, that they will abide by these Rules; and
- e. Affiliate use of utility employees shall be conducted pursuant to a written agreement approved by the appropriate utility and affiliate officers.

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule IV.E.3. If applicable, California American Water will include any such use of its employees in its annual reports to the Commission.

Sotomayor Conclusion: Based on observations and inquiries of management, it was noted that California American Water does not authorize temporary or intermittent use of its employees by covered affiliates. The transfers that occurred in 2019 and 2020 were all permanent transfers.

RULE V – Shared Corporate Support

Rule V.A. – A utility, its parent company, or a separate affiliate created solely to perform corporate support services may share with its affiliate's joint corporate oversight, governance, support systems, and personnel as further specified in these Rules. Any shared support shall be priced, reported and conducted in accordance with these Rules as well as other applicable Commission pricing and reporting requirements.

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule V.A. The portion of the fully loaded costs of shared corporate support services that benefits an affiliate are charged to the benefitted affiliate. California American Water interprets this Rule as requiring allocations to be made pursuant to Rule IV.B, currently effective general rate case decisions, or other applicable pricing and reporting requirements specifically identified by the Commission.

Sotomayor Conclusion: Based on documentation and transactions reviewed, it was noted that corporate shared services provided by the Service Company are accurately reported and fully reimbursed under Rule IV.B.

Rule V.B. – Corporate support shall not be shared in a manner that allows or provides a means for the transfer of confidential information from the utility to the affiliate, creates the opportunity for preferential treatment or unfair competitive advantage, leads to customer confusion, or creates significant opportunities for cross-subsidy of affiliates. The restriction on transfer of confidential information from the utility to the affiliate does not apply to corporate support, shared services and access to capital.

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule V.B. California American Water provides training to its employees and affiliate employees and issues periodic communications to its employees educating them on the requirements of the Rules.

Sotomayor Conclusion: Based on our review of transactions and inquiries of management, California American Water upholds that the restriction on the transfer of confidential information does not apply to shared corporate services. We agree with the conclusion reached in D.10-10-019, which states “*It is reasonable to allow water and sewer utilities to share non-public or proprietary information with their affiliates for the limited purposes of shared corporate services, as long as there are sufficient limits on other sharing of nonpublic or proprietary information*”.

Rule V.C. – Examples of services that may be shared include: corporate governance and oversight, payroll, taxes, shareholder services, insurance, financial reporting, financial planning and analysis, corporate accounting, corporate security, human resources (compensation, benefits, employment policies), employee records, regulatory affairs, lobbying, legal, and pension management, engineering, water or sewage for resale, water storage capacity, and purchasing of water distribution systems.

California American Water Compliance: California American Water affirms that all of the services listed in Rule V.C may be shared. California American Water interprets this Rule to allow for additional services, other than those specifically prohibited by Rule V.D, to be shared.

Sotomayor Conclusion: During our examination, it was noted that California American Water receives a number of shared corporate services from the Service Company, which fit the parameters of Rule V.C. and are provided for and paid for in accordance with Rules IV.B. and Rule V.A.

Rule V.D. – Examples of services that may not be shared include: hedging and financial derivatives and arbitrage services, and marketing.

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule V.D. California American Water provides training and issues periodic communications to employees educating them on the requirements of the Rules.

Sotomayor Conclusion: During our examination, we reviewed training materials and communication issued to employees regarding this part of the Rules. Based on observations and inquiries with personnel, it was determined that shared corporate services provided by the Service Company do not include hedging and financial derivatives and arbitrage services, and marketing.

RULE VI – Pricing of Goods and Services between the Utility and Its Affiliate(s)

To the extent that these Rules do not prohibit the transfer of goods and services between a utility and its affiliates:

VI.A. – Transfers from the utility to its affiliates of goods and services offered by the utility on the open market will be priced at fair market value.

VI.B. – Transfers from an affiliate to the utility of goods and services offered by the affiliate on the open market shall be priced at no more than fair market value.

VI.C. – For goods or services for which the price is regulated by a state agency, that price shall be deemed to be the fair market value, except that in cases where more than one state commission regulates the price of goods or services, this Commission’s pricing provisions govern.

VI.D. – Goods and services produced, purchased or developed to be offered on the open market by the utility shall be provided to the utility’s affiliates and unaffiliated companies on a nondiscriminatory basis, except as otherwise required or permitted by these Rules or applicable law.

VI.E. – Transfers from the utility to its affiliates of goods and services not produced, purchased or developed to be offered on the open market by the utility shall be priced at fully allocated cost plus 5% of direct labor cost.

VI.F. – Transfers from an affiliate to the utility of goods and services not produced, purchased or developed to be offered on the open market by the affiliate shall be priced at the lower of fully loaded cost or fair market value.

VI.G. – The utility shall develop a verifiable and independent appraisal of fair market value for any goods or services that are transferred to any affiliated company at fair market value under these Rules. The Commission’s staff shall have access to all supporting documents used in the development of the fair market value. If sufficient support for the appraisal of fair market value

does not exist to the reasonable satisfaction of the Commission's staff, the utility shall hire an independent consultant acceptable to the Commission staff to reappraise the fair market value for these transactions.

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with these Rules. California American Water provides training and issues period communications to employees educating them on the requirements of the Rules.

Sotomayor Conclusion: California American Water is in compliance with Rule VI. California American Water reported a total of \$18.2M and \$16.9M in intercompany transactions for years 2020 and 2019, respectively. These amounts are included in Schedule E-4, line b of the Annual Report filed with the Commission. Testing of transactions, review of documentation and observations and inquiries from personnel have revealed that California American Water has adequate procedures in place to ensure compliance with Rule VI.

RULE VII – Financial Health of the Utility

VII.A. – The parent shall provide the utility with adequate capital to fulfill all of its service obligations prescribed by the Commission.

California American Water Compliance: California American Water maintains communications with its parent to appropriately comply with Rule VII.A.

Sotomayor Conclusion: Based on observations and interviews with management, it was determined that the parent company provided California American Water with adequate capital to fulfill all of its service obligations prescribed by the Commission. We analyzed the ratios of California American Water's parent company, AWWC and California American Water based on the National Regulatory Research Institute Distress Classification Model for water utilities and it was determined that they are in good financial health conditions. As of December 31, 2020, California American Water had a line of credit with American Water Capital Corporation, a subsidiary of American Water Works in the amount of \$110 million. As of December 31, 2020, there was \$49,185,000 of short-term debt outstanding.

Rule VII.B. – If the parent is publicly traded, the utility shall notify the Director of the Commission's Division of Water and Audits and the Director of the Division of Ratepayer Advocates in writing within 30 days of any downgrading to the bonds of the parent, another affiliate, and/or the utility, and shall include with such notice the complete report of the issuing bond rating agency.

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule VII.B. California American Water regularly requests this information from appropriate affiliate representatives.

Sotomayor Conclusion: Documentation was reviewed, and inquiries were made to determine that California American Water has complied with Rule VII.B.

Rule VII.C. – The creation of a new affiliate by the parent or another affiliate shall not adversely impact the utility’s operations and provision of service.

California American Water Compliance: California American Water maintains communications as necessary with its parent and affiliates to appropriately comply with this Rule.

Sotomayor Conclusion: California American Water is in compliance with Rule VII.C.

Rule VII.D – Debt of the utility’s parent or other affiliates shall not be issued or guaranteed or secured by the utility.

California American Water Compliance: California American Water has adequate procedures, mechanisms or policies in place to comply with Rule VII.D.

Sotomayor Conclusion: During the examination, we reviewed California American Water’s audit report to determine whether there was any debt guaranteed by California American Water of the parent or any affiliate. We also confirmed with management that California American Water has not guaranteed any debt of the parent or affiliates. California American Water has complied with Rule VII.D. All debt issued by American Water Capital Corporation was unsecured.

Rule VII.E. – Financial Separation. Within three months of the effective date of the decision adopting these Rules, each utility with a parent company shall file a Tier III advice letter proposing provisions that are sufficient to prevent the utility from being pulled into the bankruptcy of its parent company. The process specified by the Advice Letter Filing shall include a verification that the provisions have been implemented and signed by the utility’s senior management (e.g., the Chief Executive Officer, Chief Financial Officer, and General Counsel).

California American Water Compliance: Pursuant to the conditions stated in the letter from Commission Executive Director Paul Clanon to California Water Association Attorney Jose E. Guzman, Jr., dated December 9, 2010, California American Water complied with this Rule by filing its Tier III advice letter No. 884 on March 31, 2011. The compliance deadline for this Rule was extended by the Executive Director of the Commission until the Commission adopted a resolution on the matter due to the significant differences in interpretation of the Rules between the water utilities and the Division of Ratepayer Advocates (now known as the Public Advocates Office). California American Water’s Advice Letter No. 884 was adopted by the Commission on August 14, 2014. California American Water has implemented its provisions and will maintain appropriate procedures and mechanisms as necessary to help ensure compliance with this Rule.

Sotomayor Conclusion: We believe that California American Water is in compliance with Rule VII.E. California American Water received correspondence from the Commission via Resolution No. W-4984, which advised various utility companies to change their ring-fencing plans. The Commission did not direct California American Water to make any changes to its ring-fencing plans, from which we infer that the Commission was satisfied with the Plan.

Rule VII.F. – Rules VI, VII, VIII(B) and VIII(C) adopted in Decision 97-12-011 (applicable to California Water Service Company), and Rules 12, 13, 15 and 16 adopted in Decision 98-06-068 (applicable to Golden State Water Company), continue in effect for those companies only.

California American Water Compliance: This Rule does not apply to California American Water.

Sotomayor Conclusion: Based on discussion with California American Water management, this Rule does not apply to California American Water.

RULE VIII – Regulatory Oversight

Rule VIII.A – The officers and employees of the utility and its affiliated companies shall be available to appear and testify in any proceeding before the Commission involving the utility. If, in the proper exercise of the Commission staff's duties, the utility cannot supply appropriate personnel to address the staff's reasonable concerns, then the appropriate staff of the relevant utility affiliated companies including, if necessary, its parent company, shall be made available to the Commission staff.

California American Water Compliance: California American Water maintains appropriate procedures and mechanisms to help ensure compliance with Rule VIII.A. California American Water will continue to make the relevant officers and employees of the utility and its covered affiliates available to testify before the Commission, as necessary or required, consistent with the provisions of Public Utilities Code Section 314 and Decision 02-12-068.

Sotomayor Conclusion: During our examination, we confirmed that California American Water management would make any officers or employees available for any Commission proceeding.

Rule VIII.B. – The utility and its affiliated companies shall provide the Commission, its staff, and its agents with access to the relevant books and records of such entities in connection with the exercise by the Commission of its regulatory responsibilities in examining any of the costs sought to be recovered by the utility in rate proceedings or in connection with a transaction or transactions between the utility and its affiliates. The utility shall continue to maintain its books and records in accordance with all Commission rules. The utility's books and records shall be maintained and housed available in California.

California American Water Compliance: California American Water maintains appropriate procedures and mechanisms to help ensure compliance with Rule VIII.B. California American Water will continue to make its relevant books and records open for examination by the Commission and its staff, consistent with the provisions of Public Utilities Code Section 314 and Decision 02-12-068.

Sotomayor Conclusion: During the examination, we requested access to the relevant books and records in order to complete observations and testing under this Rule. These records were maintained at the Service Company location in Camden, NJ. These records are on a shared drive,

which authorized personnel at the California American Water headquarters in San Diego have access to.

Rule VIII.C. – Compliance Plans. Each utility shall include a compliance plan as part of its annual report, starting in 2011 with the 2010 annual report and biennially thereafter. The compliance plan shall include:

1. A list of all affiliates of the utility, as defined in Rule II.D, and for each affiliate a description of its purposes or activities, and whether the utility claims that Rule I.B makes any portion of these Rules applicable to the affiliate;
2. A description of the procedures in place to assure compliance with these Rules; and
3. A description of both the specific mechanisms and the procedures that the utility and parent company have in place to assure that the utility is not utilizing the parent company or any of its affiliates not covered by these Rules as a conduit to circumvent any of these Rules in any respect. The description shall address, but shall not be limited to (a) the dissemination of information transferred by the utility to an affiliate covered by these Rules, (2) the provision of services to its affiliates covered by these Rules or (c) the transfer of employees to its affiliates covered by these Rules in contravention of these Rules. A corporate officer from the utility and parent company shall verify the adequacy of these specific mechanisms and procedures to ensure that the utility is not utilizing the parent company or any of its affiliates not covered by these Rules as a conduit to circumvent any of these Rules.

California American Water Compliance: California American Water filed its initial compliance plan with the Commission in March of 2011 and again in May of 2011. California American Water subsequently filed biennial Compliance Plans in June of 2013, June of 2015, May of 2017, June of 2019, and anticipates this Plan to be filed in or about June of 2021 or as otherwise authorized by the Commission. California American Water has implemented appropriate procedures and mechanisms to help ensure compliance with Rule VIII.C. California American Water has attached a current list of its affiliates to this 2021 Plan as Appendix A. California American Water believes its compliance plans comply with Rule VIII.C.

Sotomayor Conclusion: During the examination, we determined that the compliance plans filed with the Commission contained the information required in items 1 through 3.

Rule VIII.D. – New Affiliates. Upon the creation of a new affiliate, the utility shall immediately notify the Commission of its creation, as well as posting notice of this event on its web site. No later than 60 days after the creation of this affiliate, the utility shall file an information-only filing, as provided for in Rule 6.1 of General Order 96-B, with the Director of the Commission’s Division of Water and Audits, with service on the Director of the Division of Ratepayer Advocates. The advice letter shall state the affiliate’s purpose or activities and whether the utility claims these Rules are applicable to the new affiliate, and shall include a demonstration to the Commission that there are adequate procedures in place that will assure compliance with these Rules. The advice letter may include a request, including supporting explanation, that the affiliate transaction rules

not be applied to the new affiliate. If the utility requests that the affiliate transactions rules not be applied to the new affiliate, in lieu of an information-only filing, the utility shall file a Tier 2 advice letter making such a request, including an explanation of why these Rules should not apply to the new affiliate.

California American Water Compliance: California American Water has implemented procedures and mechanisms to help ensure compliance with Rule VIII.D. California American Water regularly requests this information from appropriate affiliate representatives.

Sotomayor Conclusion: During the examination, we inquired management and personnel about the process followed for notification of the creation of new affiliates. We obtained the filings sent to the Commission to notify them of the new affiliates. No late filing was discovered. California American Water has strengthened its procedures to help ensure the timely reporting. California American Water provided the required notifications to the Commission for all new affiliates created during 2019 and 2020. No exception.

Rule VIII.E. – Independent Audits. Commencing in 2013, and biennially thereafter, the utility shall have an audit performed by independent auditors 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. The audits shall cover the last two calendar years which end on December 31st, and shall verify that the utility is in compliance with these Rules. The utility shall submit the audit report to the Director of the Division of Water and Audits and the Director of the Division of Ratepayer Advocates no later than September 30th of the year in which the audit is performed. The Division of Water and Audits shall post the audit reports on the Commission's web site. The audits shall be at shareholder expense.

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with this Rule. California American Water submitted its 2013, 2015, 2017 and 2019 audit reports to the Commission as require by Rule VIII.E.

Sotomayor Conclusion: Sotomayor & Associates, LLP performed the required audit for the period January 1, 2019 to December 31, 2020.

Rule VIII.F. – Annual Affiliate Transaction Reports. Each year, by March 31, the utility shall submit a report to the Director of the Division of Water and Audits and the Director of the Division of Ratepayer Advocates that includes a summary of all transactions between the utility and its affiliated companies for the previous calendar year. The utility shall maintain such information on a monthly basis and make such information available to the Commission's staff upon request. The summary shall include a description of each transaction and an accounting of all costs associated with each transaction although each transaction need not be separately identified where multiple transactions occur in the same account (although supporting documentation for each individual transaction shall be made available to the Commission staff upon request). These transactions shall include the following:

1. Services provided by the utility to the affiliated companies;

2. Services provided by the affiliated companies to the utility;
3. Assets transferred from the utility to the affiliated companies;
4. Assets transferred from the affiliated companies to the utility;
5. Employees transferred from the utility to the affiliated companies;
6. Employees transferred from the-affiliated companies to the utility;
7. The financing arrangements and transactions between the utility and the affiliated companies;
8. Services provided by and/or assets transferred from the parent holding company to affiliate company which may have germane utility regulations impacts; and
9. Services provided by and/or assets transferred from affiliated company to the parent holding company which may have germane utility regulation impacts.

California American Water Compliance: California American Water maintains appropriate procedures and mechanisms to help ensure compliance with Rule VIII. F. California American Water affirms that, as part of its annual reports to the Commission, it will submit an affiliate transactions report to the Director of the Water Division (formerly known as the Director of the Division of Water and Audits) and the Director of the Office of Public Advocates Office (formerly known as the Office of Ratepayer Advocates) that includes a summary of all transactions between the utility and its affiliated companies for the previous calendar year. With respect to Rules VIII.F.8 and VIII.F.9, California American Water interprets these rules to apply to affiliates and affiliate transactions covered in Rule 1.B.

Sotomayor Conclusion: During the examination, we reviewed copies of the 2019 and 2020 annual reports on affiliate transactions and determined that they contained the information required in items 1 through 9 of this Rule.

RULE IX – Confidentiality

Any records or other information of a confidential nature furnished to the Commission pursuant to these Rules that are individually marked Confidential are not to be treated as public records and shall be treated in accordance with P. U. Code § 583 and the Commission’s General Order 66-D, or their successors.

California American Water Compliance: California American Water will individually mark such records or information as Confidential.

Sotomayor Conclusion: To confirm that California American Water properly indicates confidential information, we performed the following:

- Discussed Rule IX with California American Water executive management and legal personnel
- Examined California American Water’s training materials offered to all personnel
- Examined California American Water’s compliance plan

- Examined documentation provided to the Commission including a number of filings made under the Rules. We verified that any proprietary information provided to the Commission was identified as confidential information.

California American Water complies with Rule IX by specifying what information is to be treated as confidential.

RULE X – Provision of Non-tariffed Products and Services (NTP&S)

X.A. – Except as provided for in these rules, new products and services shall be offered through affiliates.

Sotomayor Conclusion: California American Water is in compliance with Rule X.A. California American Water offers two types of NTP&S which include antenna leases and real property lease. Both types of NTP&S are categorized as passive activities in accordance with the Commission's NTP&S schedule as part of the Rules. For antenna leases and real property lease, agreements in place dictate the payment to be made to California American Water by the lessee/tenant for leasing the use of the facilities/leased premises. Based on documentation reviewed and discussions with California American Water management, they initiated two new NTP&S items during 2019 and 2020 that are listed in the Commission's NTP&S schedule. All other current NTP&S have been offered for many years, prior to the adoption of the Rules by the Commission.

X.B. – A utility may only offer on the open market the following products and services:

1. Existing products and services offered by the utility pursuant to tariff;
2. New products and services that are offered on a tariffed basis; and
3. Products and services that are offered on a non-tariffed basis (NTP&S) and that meet the following conditions:
 - a. The NTP&S utilizes a portion of the excess or unused capacity of a utility asset or resource;
 - b. Such asset or resource has been acquired for the purpose of and is necessary and useful in providing tariffed utility services;
 - c. The involved portion of such asset or resource may only be used to offer the product or service on a non-tariffed basis without adversely affecting the cost, quality or reliability of tariffed utility products and services;
 - d. The products and services can be marketed with minimal or no incremental ratepayer capital, minimal or no new forms of liability or business risk being incurred by utility ratepayers, and no undue diversion of utility management attention; and

- e. The utility's offering of the NTP&S does not violate any California law, regulation, or Commission policy regarding anticompetitive practices.

Sotomayor Conclusion: See discussion under Rule X.A. above. Based on the above, California American Water is in compliance with Rule X.B.

X.C. – Revenues. Gross revenue from NTP&S projects shall be shared between the utility's shareholders and its ratepayers. In each general rate case, NTP&S revenues shall be determined and shared as follows:

1. Active NTP&S projects: 90% shareholder and 10% ratepayer.
2. Passive NTP&S projects: 70% shareholder and 30% ratepayer.
3. A utility shall classify all NTP&S as active or passive according to the table below. For a new NTP&S not listed in the table, which requires approval by the Commission by advice letter pursuant to Rule X.G, an "active" project requires a shareholder investment of at least \$125,000. Otherwise the new NTP&S shall be classified as passive. No costs recoverable through rates shall be counted toward the \$125,000 threshold.
4. Revenues received that are specified in a contract as pass-through of costs, without any mark-up, shall be excluded when determining revenue sharing. If an advice letter is required pursuant to Rule X.G, the utility shall specify in the advice letter any items other than postage, power, taxes, and purchased water for which it proposes pass-through treatment and must obtain Commission approval for such treatment.
5. For those utilities with annual Other Operating Revenue (OOR) of \$100,000 or more, revenue sharing shall occur only for revenues in excess of that amount. All NTP&S revenue below that level shall accrue to the benefit of ratepayers.
6. For those utilities with annual OOR below \$100,000, there shall be no sharing threshold, and ratepayers shall accrue all benefits for non-tariffed products and services.

Sotomayor Conclusion: California American Water is in compliance with Rule X.C. During the examination, we obtained documentation to support the billing method used for NTP&S revenues and allocation of NTP&S revenue to shareholders and ratepayers in accordance with Rule X.C. California American Water offers two types of NTP&S items; antenna leases and real property lease. The antenna leases and real property lease are categorized as passive in accordance with the Commission NTP&S schedule. Based on the documentation reviewed, California American Water passed revenue derived from NTP&S activity to the ratepayers through the general rate cases and rate reductions.

X.D. – Cost Allocation. All costs, direct and indirect, including all taxes, incurred due to NTP&S projects shall not be recovered through tariffed rates. These costs shall be tracked in separate accounts and any costs to be allocated between tariffed utility services and NTP&S shall be

documented and justified in each utility's rate case. More specifically, all incremental investments, costs, and taxes due to non-tariffed utility products and services shall be absorbed by the utility shareholders, i.e., not recovered through tariffed rates.

Sotomayor Conclusion: During the examination, we obtained documentation to support the billing method used for NTP&S costs. Costs are incurred and billed directly to the lessees under the various antenna leases held by California American Water. These costs are recovered through direct billing of costs to NTP&S recipients and revenue is allocated to shareholders/ratepayers in accordance with Rule X.C. California American Water is in compliance with Rule X.D.

Rule X.E. – Annual Report of NTP&S Projects. Each utility shall include information regarding its NTP&S projects in its Annual Reports, including but not be limited to the following:

1. A detailed description of each NTP&S activity;
2. Whether and why it is classified active or passive;
3. Gross revenue received;
4. Revenue allocated to ratepayers and to shareholders, as established in the company's current general rate case;
5. A complete identification of all regulated assets used in the transaction;
6. A complete list of all employees (by position) that participated in providing the non-tariffed service, with amount of time spent on provision of the service;
7. If the NTP&S has been classified as active through advice letter submission, provide the number of the advice letter and the authorizing Resolution; and
8. If the NTP&S did not require approval through advice letter, provide the date notice was given to the Commission.

Sotomayor Conclusion: During our examination, we reviewed copies of the 2019 and 2020 Annual Report of NTP&S Projects. This report is also known as an Excess Capacity Report included as part of the Class A Annual Report sent to the Commission. California American Water confirmed that the templates used for the Excess Capacity Schedule were obtained from the Commission and these templates do contain all required items under Rule X.E. It was also confirmed that the only NTP&S report that currently exists is the Excess Capacity Schedule included with the Class A Annual Report. We believe California American Water is in compliance with Rule X.E. based on the information reviewed.

Rule X.F. – When a utility initiates the offering of NTP&S that are designated as active or passive in the table below, the utility shall provide notice of such activity by letter to the Director of the

Division of Water and Audits and the Program Manager of the Division of Ratepayer Advocates-Water Branch, within 30 days of instituting such activity.

Sotomayor Conclusion: California American Water is compliant with Rule X.F. California American Water initiated one new NTP&S items during the 24 months ended December 31, 2020. On May 16, 2019, California American Water commenced a one-time consultation service with South Coast Water District. During the examination, we obtained the filings sent to the Commission regarding the initiation of new NTP&S and no late notification was discovered.

Rule X.G. – Provision of New NTP&S. Any water or sewer utility that proposes to engage in the provision of new NTP&S not included in the table below, using the excess capacity of assets or resources reflected in the utility’s revenue requirement, and which are proposed to be classified as active as described herein, shall file a Tier 3 advice letter (see Resolution ALJ-202) with the Director of the Division of Water and Audits seeking Commission approval. The advice letter shall be served on the service list for Rulemaking 09-04-012 and the service list for the utility’s current or most recent general rate case. The advice letter shall contain the following:

1. A full description of the proposed NTP&S, including, without limitation, the identity of parties served (if known), revenue and cost forecasts, and the term of any contract to be employed.
2. A description of the accounting method to be used to allocate the incremental costs between tariffed services and caused by the NTP&S.
3. Copies of all operative documents for the proposed service.
4. A detailed description of any items other than postage, power, taxes, and purchased water for which the utility proposes pass-through treatment for purposes of calculating revenue sharing.
5. Complete identification of all utility regulated assets and personnel resources that will be used in the proposed transaction. Identify the particular excess capacity (or capacities) asset or resource to be used to provide the NTP&S.
6. A complete list of all employees that will participate in providing the service, with an estimate of the amount of time each will spend.
7. A showing that the proposed NTP&S may be offered without adversely affecting the cost, quality, or reliability of the utility services.
8. A showing of how the NTP&S will be marketed with minimal or no incremental ratepayer capital, minimal or no new forms of liability or business risk, and no undue diversion of utility management attention.

9. A showing of how the NTP&S does not violate any law, regulation, or Commission policy regarding anti-competitive practices.
10. A justification for classifying the NTP&S as active. The utility shall demonstrate that there is or will be incremental shareholder investment above \$125,000.
11. A statement that all risks incurred through this proposed NTP&S project shall be borne by the utility's shareholders.
12. A description of the market served by the proposed NTP&S project, a list or description of the current incumbents in that market, and an analysis of how the utility's entry into the market will affect the market's competitiveness. Include in this analysis a description of how the utility will guard against using anti-competitive pricing in this market.
13. Any other information, opinions, or documentation that might be relevant to the Commission's consideration of the NTP&S.

California American Water Compliance: California American Water has implemented procedures and mechanisms to comply with Rule X. California American Water files reports on Non-Tariffed Products and Services with its annual reports to the Commission. California American Water provides training and issues periodic communications to employees educating them on the requirements of the Rules.

Sotomayor Conclusion: Based on our discussions with California American Water, in addition to the existing NTP&S products/ services that have been provided for many years, there was one new NTP&S items initiated. All NTP&S items are classified as passive, it is concluded that California American Water is in compliance with Rule X.G.

Appendix B – BlackRock, Inc. Procedure

This audit included, at the request of California American Water, a procedure to verify if any transactions have occurred between California American Water and BlackRock, Inc. during the audit period. The procedure is related to an advice letter filed in 2013 by California American Water regarding BlackRock, Inc.

Background

On February 4, 2013, California American Water filed Advice Letter 990 (“AL 990”) under Rule VIII.D. In AL 990, California American Water requested that Rules not be applied to BlackRock, Inc., a private investment management holding company (“BlackRock”) that had acquired more than 10% of American Water’s stock. AL 990 was protested by the Division of Ratepayer Advocates, and subsequently suspended by the Division of Water and Audits (“DWA”). Thereafter, California American Water supplemented AL 990 by filing Advice Letter 990-A and Advice Letter 990-B (“AL 990-B”), wherein California American Water requested that Rules VII.B, VIII.A, VIII.B and VIII.D not be applied to BlackRock on certain conditions, including the condition that there are no affiliate transactions between BlackRock and California American Water. California American Water was informed of the approval of AL 990-B by DWA letter dated April 30, 2015, with an effective date of January 4, 2015.

Audit Procedure

- Obtain report of all California American Water payments made between January 1, 2019 and December 31, 2020.
- Obtain contracts listing between January 1, 2019 and December 31, 2020.
- Obtain master vendor listing between January 1, 2019 and December 31, 2020.
- Scan through the reports obtained and search for any transactions that may have occurred between California American Water and BlackRock, Inc.

Findings

Based on the documentation reviewed and discussions with California American Water management, no transactions took place between California American Water and BlackRock, Inc

Appendix C – The Vanguard Group Procedure

This audit included, at the request of California American Water, a procedure to verify if any transactions have occurred between California American Water and The Vanguard Group. during the audit period. The procedure is related to an advice letter filed in 2017 by California American Water regarding The Vanguard Group.

Background

On August 29, 2017, California American Water filed Advice Letter 1169-A (“AL 1169-A”) under Rule VIII.D. In AL 990, California American Water requested that Rules not be applied to The Vanguard Group, a private investment management holding company (“The Vanguard Group”) that had acquired more than 10% of American Water’s stock. California American Water was informed of the approval of AL 1169-A by DWA letter with an effective date of September 7, 2017.

Audit Procedure

- Obtain report of all California American Water payments made between January 1, 2019 and December 31, 2020.
- Obtain contracts listing between January 1, 2019 and December 31, 2020.
- Obtain master vendor listing between January 1, 2019 and December 31, 2020.
- Scan through the reports obtained and search for any transactions that may have occurred between California American Water and The Vanguard Group.

Findings

Based on the documentation reviewed and discussions with California American Water management, no transactions took place between California American Water and The Vanguard Group.