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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

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CHAIRMAN

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JIM IRVIN
COMMISSIONER

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MARC SPITZER
COMMISSIONER

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IN THE MATTER OF THE JOINT APPLICATION BETWEEN CITIZENS UTILITIES COMPANY; AGUA FRIA WATER DIVISION OF CITIZENS UTILITIES COMPANY; MOHAVE WATER DIVISION OF CITIZENS UTILITIES COMPANY; SUN CITY WATER COMPANY; SUN CITY SEWER COMPANY; SUN CITY WEST UTILITIES COMPANY; CITIZENS WATER SERVICES COMPANY OF ARIZONA; CITIZENS WATER RESOURCES COMPANY OF ARIZONA; HAVASU WATER COMPANY AND TUBAC VALLEY WATER COMPANY, INC., FOR APPROVAL OF THE TRANSFER OF THEIR WATER AND WASTEWATER UTILITY ASSETS AND THE TRANSFER OF THEIR CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY TO ARIZONA-AMERICAN WATER COMPANY AND FOR CERTAIN RELATED APPROVALS.

- Docket No. W-01032A-00-0192
- Docket No. W-01032B-00-0192
- Docket No. W-01032C-00-0192
- Docket No. W-01656B-00-0192
- Docket No. SW-2276A-00-0192
- Docket No. WS-02334A-00-0192
- Docket No. WS-03454A-00-0192
- Docket No. WS-03455A-00-0192
- Docket No. WS-02013A-00-0192
- Docket No. W-01595A-00-0192
- Docket No. W-01303A-00-0192

**RUCO'S NOTICE OF FILING
PROPOSED FORM OF OPINION
AND ORDER**

The Residential Utility Consumer Office ("RUCO") hereby files its proposed form of Opinion and Order in the above-entitled matter.

RESPECTFULLY SUBMITTED this 14th day of February, 2001.

Daniel W. Pozefsky
Attorney, RUCO

1 AN ORIGINAL AND TEN COPIES
of the foregoing filed this 14th day of
2 February, 2001 with:

3 Docket Control
Arizona Corporation Commission
4 1200 West Washington
Phoenix, Arizona 85007

5
6 COPIES of the foregoing hand delivered/
mailed this 14th day of February, 2001 to:

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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 WILLIAM MUNDELL
CHAIRMAN

3 JIM IRVIN
COMMISSIONER

4 MARC SPITZER
COMMISSIONER

5
6 IN THE MATTER OF THE JOINT
APPLICATION BETWEEN CITIZENS
UTILITIES COMPANY; AGUA FRIA
7 WATER DIVISION OF CITIZENS
UTILITIES COMPANY; MOHAVE WATER
8 DIVISION OF CITIZENS UTILITIES
COMPANY; SUN CITY WATER
9 COMPANY; SUN CITY SEWER
COMPANY; SUN CITY WEST UTILITIES
10 COMPANY; CITIZENS WATER
SERVICES COMPANY OF ARIZONA;
11 CITIZENS WATER RESOURCES
COMPANY OF ARIZONA; HAVASU
12 WATER COMPANY AND TUBAC
VALLEY WATER COMPANY, INC., FOR
13 APPROVAL OF THE TRANSFER OF
THEIR WATER AND WASTEWATER
14 UTILITY ASSETS AND THE TRANSFER
OF THEIR CERTIFICATES OF PUBLIC
15 CONVENIENCE AND NECESSITY TO
ARIZONA-AMERICAN WATER
16 COMPANY AND FOR CERTAIN
RELATED APPROVALS.

Docket No. W-01032A-00-0192
Docket No. W-01032B-00-0192
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Docket No. WS-03454A-00-0192
Docket No. WS-03455A-00-0192
Docket No. WS-02013A-00-0192
Docket No. W-01595A-00-0192
Docket No. W-01303A-00-0192

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18 DECISION NO. _____

OPINION AND ORDER

19 DATE OF HEARING: September 27, 2000

20 PLACE OF HEARING: Phoenix, Arizona

21 ADMINISTRATIVE LAW JUDGE: Karen E. Nally

22 APPEARANCES: Mr. Michael M. Grant, GALLAGHER & KENNEDY,
and Mr. Craig Marks, Associate General Counsel, on
23 behalf of Citizens Communications Company;
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1 Mr. Norman D. James, FENNEMORE CRAIG, on
2 behalf of Arizona-American Water Company;

3 Mr. Daniel W. Pozefsky, Staff Attorney, on behalf of
4 Residential Utility Consumer Office;

5 Mr. Bill Meek on behalf of the Arizona Utility Investors
6 Association; and

7 Ms. Teena Wolfe, Staff Attorney, Legal Division, on
8 behalf of the Utilities Division of the Arizona
9 Corporation Commission

10 **BY THE COMMISSION:**

11 On March 24, 2000, Citizens Utilities Company, now known as Citizens
12 Communications Company, together with its Agua Fria Water Division, Mohave Water
13 Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities
14 Company, Citizens Water Services Company of Arizona, Citizens Water Resources Company
15 of Arizona, Havasu Water Company and Tubac Valley Water Company (collectively
16 "Citizens"), and Arizona-American Water Company ("Arizona-American") filed with the Arizona
17 Corporation Commission ("Commission") a joint application for approval of the transfer of
18 Citizens' water and wastewater utility plant and assets in Arizona and the transfer of Citizens'
19 Certificates of Convenience and Necessity ("Certificates") to Arizona-American.

20 On May 17, 2000, the Residential Utility Consumer Office ("RUCO") filed a motion for
21 leave to intervene, which was granted on June 1, 2000. The Arizona Utility Investors
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1 Association ("AUIA") filed a motion to intervene on June 1, 2000, which was granted on June
2 16, 2000.¹

3 In accordance with the procedural Order issued in this matter on May 30, 2000, Citizens
4 and Arizona-American caused a public notice of the application and hearing to be published in
5 various newspapers throughout Arizona.

6 In addition to publishing notice of the application, all customers of Citizens were notified
7 of the application by means of a written bill insert. A formal public comment session
8 concerning the application was also held on September 14, 2000, in Sun City.

9 On September 26, 2000, the Utilities Division Staff ("Staff") of the Commission filed a
10 Settlement Agreement ("Settlement Agreement") between Staff and Arizona-American, which
11 is attached hereto as Exhibit A. Following the hearing on this matter, which was held on
12 September 27, 2000 at the Commission's offices in Phoenix, Citizens and RUCO submitted
13 written briefs on the issue of whether Citizens should be required to pay a portion of the gain
14 resulting from the sale of the utility plant and assets to Citizens' customers.

15
16 **DISCUSSION**

17 **Parties to the Transaction**

18 Citizens Communications Company ("CCC"), through its various divisions and
19 subsidiaries, provides water and wastewater, electric, natural gas and telecommunications
20

21 ¹ On April 10, 2000, Mr. Marvin Lustiger filed a request to intervene in the above-captioned matter. However, by
22 subsequent filing, Mr. Lustiger clarified that he was only interested in electric or telephone service in Mohave
23 County, on which basis Mr. Lustiger's request to intervene was deemed to have been withdrawn.

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1 services to approximately 1.8 million customers in 22 states, including Arizona. CCC's current
2 business strategy is to focus on the provision of telecommunications services and to expand its
3 telecommunications subsidiaries' operations through the acquisition of wire centers and access
4 lines from other providers, primarily in rural areas.

5 In connection with this business strategy, CCC intends to sell its water and wastewater,
6 electric, and natural gas services properties and to utilize the proceeds to finance acquisitions
7 and other business activities in the telecommunications area. CCC has entered into an
8 agreement to sell its Arizona electric utility systems and assets to Cap Rock Energy
9 Corporation.² In April 2000, CCC also announced the sale of its Louisiana natural gas
10 operations for \$375 million.

11 Arizona-American presently provides water service to approximately 4,600 customers in
12 portions of the Town of Paradise Valley, the City of Scottsdale and certain unincorporated
13 portions of Maricopa County. Arizona-American holds a Certificate of Convenience and
14 Necessity granted by the Commission, and is presently classified as a Class B water utility.
15 Arizona-American is a wholly owned subsidiary of American Water Works Company, Inc.
16 ("AWW").

17 AWW is the largest privately owned water utility system in the United States, providing
18 water, wastewater and other water resource management services to approximately 3 million
19 customers in 23 states.

20
21
22 ² An application for approval of the sale and transfer of Citizens' electric utility assets and systems in Arizona is
23 presently pending in Docket Nos. E-01032A-00-0163; E-01032B-00-0163; E-01032C-00-0163; and E-03851A-00-
0163.

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1 AWW entered into an agreement to acquire all of the water and wastewater systems of
2 CCC and its subsidiaries in October 1999. In addition to Arizona, CCC presently has water
3 and wastewater systems in the states of Illinois, California, Pennsylvania, Ohio and Indiana.

4 AWW is financially sound. On December 31, 1999, AWW reported consolidated net
5 plant of \$5.1 billion and operating revenues of \$1.26 billion. Its December 31, 1999, balance
6 sheet reflected a capital structure of 58.4 percent long-term debt, 2.3 percent preferred stock
7 and 39.3 common equity, which ratios are comparable to the six publicly traded water utilities
8 followed by Value Line Investment Survey. AWW's shares of common stock, which are
9 publicly traded on the New York Stock Exchange, received the highest Safety Rank from Value
10 Line.

11 In 1999, AWW's subsidiaries invested \$467 million in improving and upgrading their
12 facilities. For the past several years, similar expenditures have averaged nearly \$400 million
13 per year. According to AWW witnesses, AWW's acquisition policy is motivated, at least in part,
14 by anticipated capital expenditures resulting from new regulatory requirements and programs
15 and the need to replace or upgrade aged infrastructure to maintain high quality service. By
16 acquiring additional water and wastewater systems, AWW and its subsidiaries hope to obtain
17 economies of scale and to strengthen their financial capability by expanding their customer
18 base.

19
20 The Transaction

21 On October 15, 1999, Citizens, Arizona-American and AWW entered into an agreement
22 under which Arizona-American would acquire the water and wastewater assets and the
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1 Certificates held by Citizens in Arizona ("the Acquired Assets"). The Acquired Assets include
2 all utility plant, property and interests relating to Citizens' water and wastewater operations in
3 Arizona, with certain exceptions, including assets commonly used by Citizens in connection
4 with other utility operations, cash and cash equivalents, and assets related to benefit plans.
5 Citizens would also retain certain liabilities, including obligations for taxes payable, obligations
6 relating to employee compensation and benefits, and refunds of certain advances in aid of
7 construction. Arizona-American would assume and be liable for all contracts and permits
8 assigned at closing, certain Industrial Development Revenue Bonds ("IDRBs"), and
9 unperformed obligations.

10 The purchase price that would be paid by Arizona-American is approximately \$231
11 million, subject to adjustment at the time of closing. The purchase price would be increased
12 based on utility plant added by Citizens after June 30, 1999, and reduced based on plant
13 retirements occurring after such date.

14 Arizona-American will finance the purchase of the Acquired Assets by a combination of
15 debt and equity. AWW recently formed a new subsidiary, American Water Capital Corp.
16 ("AWCC") that will provide loans and other financial services to AWW subsidiaries. Initially,
17 Arizona-American will borrow funds from AWCC on a short-term basis, and receive additional
18 funds in form of common equity directly from AWW. Within 12 months, the short-term debt
19 would be converted to long-term debt. Arizona-American's resulting capital structure will

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1 contain 55 to 60 percent debt and 45 to 40 percent common equity, including Arizona-
2 American's existing debt and equity capital and the Citizens' IDRBs that would be assumed.³

3
4 The Position of Staff and the Settlement Agreement

5 Staff generally supported the application, and recommended that the transfer of the
6 Acquired Assets to Arizona-American be approved, subject to several conditions.

7 First, Staff recommended that the Commission defer any decision on the ratemaking
8 treatment of an acquisition adjustment, deferred taxes, excess deferred taxes, and investment
9 tax credits until a future rate proceeding.

10 Second, Staff recommended that the decision to allow recovery of an acquisition
11 adjustment be based on Arizona-American's ability to demonstrate that clear, quantifiable and
12 substantial net benefits have been realized by ratepayers, which would not have been realized
13 had the transaction not occurred.

14 Third, Staff recommended that Arizona-American should be Ordered to file a report 13
15 months after the closing of the transaction comparing the number of complaints received by
16 the Commission and providing an explanation of any significant changes in the number and
17 importance of the complaints. Staff would then review this report and, if necessary, provide a
18 recommendation to the Commission.

19 Fourth, Staff recommended that an imputation of the benefits related to advances in aid
20 of construction ("AIAC") and contributions in aid of construction ("CIAC") received by Arizona-
21 American be made in subsequent rate proceedings for each former Citizens' system. The

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23 ³ Arizona-American has filed an application for authority to issue short-term and long-term debt in connection with

1 purpose of the imputation would be to recognize that portions of the Acquired Assets were
2 financed by AIAC and CIAC, which Arizona-American will not be assuming. Staff also
3 recommended that imputed AIAC be amortized over a period of 10 years, while imputed CIAC
4 would be amortized below the line in the same manner as would have otherwise occurred.

5 Fifth, Staff recommended that Arizona-American be required to seek Commission
6 approval of any amendments to, or transfers of agreements relating to the purchase of water,
7 such as Citizens' Central Arizona Project ("CAP") water subcontracts.

8 Finally, Staff recommended that the Commission order Arizona-American to charge
9 ratepayers for services based on the rates, charges, and service tariffs in effect at the time of
10 closing in each Citizens service territory, until such time as Arizona-American files general rate
11 proceedings for each service territory.

12 In its rebuttal filing, Arizona-American indicated that it would accept all of the conditions
13 recommended by Staff, including the deferral of a decision concerning the recognition of an
14 acquisition adjustment and the conditions under which an acquisition adjustment would be
15 recognized, and would adopt and utilize the rates and charges for service, and all other service
16 tariffs currently in effect in each of the affected Citizens' service territories. However, Arizona-
17 American disagreed with imputing Citizens' AIAC and CIAC to Arizona-American.
18 Subsequently, Staff and Arizona-American entered into the Settlement Agreement, which
19 resolved all areas of disagreement relating to the terms and conditions under which the
20 Acquired Assets would be transferred to Arizona-American.

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23 financing the purchase of the Acquired Assets, which is pending in Docket No. W-01303A-00-0929.

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1 Under the Settlement Agreement, Citizens' AIAC and CIAC would be imputed to
2 Arizona-American for ratemaking purposes (thereby reducing rate base). The amount of the
3 AIAC and CIAC to be imputed to Arizona-American for ratemaking purposes would be based
4 on the actual balances shown on Citizens' regulatory books as of the date of the transfer of the
5 Acquired Assets, adjusted as follows: an amount equal to 5 percent of Citizens' AIAC balance
6 at the time of the transfer would be reclassified as CIAC and added to the CIAC balance, and
7 the same amount would be deducted from Citizens' AIAC balance. The adjusted amount of
8 AIAC would be amortized below the line (i.e., no impact on expenses) over a period of 6.5
9 years, with the amortization period beginning on the day on which the transfer takes place.
10 The adjusted amount of CIAC would be amortized above the line (i.e., as a reduction to
11 depreciation expense that would otherwise be recoverable in rates) over a period of 10 years,
12 with the amortization period beginning on the day on which the transfer takes place. The
13 imputation of AIAC and CIAC to Arizona-American is solely for ratemaking purposes, and not
14 for financial accounting or any other purpose.

15 In addition to agreeing to the imputation of AIAC and CIAC, Arizona-American agreed
16 that the Commission may adopt the remaining conditions concerning the sale and transfer of
17 the Acquired Assets recommended by Staff, discussed above. Staff and Arizona-American
18 also agreed that Arizona-American's request for an accounting order to establish the
19 amortization method for any acquisition adjustment resulting from the transaction should be
20 deferred until a future rate case.

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1 At the hearing, AUIA indicated its acceptance of the Settlement Agreement. However,
2 RUCO objected to portions of the Settlement Agreement and to the transaction generally, as
3 discussed below.

4
5 Position of RUCO

6 RUCO maintained that the transaction as proposed is not in the public interest and
7 should not be approved, absent a restructuring of the transaction. RUCO argued that the
8 projected synergy savings would not be sufficient to offset the \$71.2 million premium paid by
9 Arizona-American. The result, according to RUCO, would be an upward influence on rates
10 and/or Arizona-American would fail to earn a fair return. RUCO agreed with Citizens and Staff
11 that consideration of an acquisition adjustment resulting from the transaction should be
12 deferred until a future rate proceeding. However, RUCO believes that it is appropriate and
13 necessary for the Commission to establish criteria for determining a recoverable amount in a
14 future rate proceeding. Although there is no ideal method for determining a recoverable
15 amount, and any method selected would have limitations, RUCO's recommended formula sets
16 forth four criterion which establish a reasonably simple and objective method for determining a
recoverable amount in future rates. This amount is based on the following:

- 17 1. A test year that ends before January 1, 2007.
- 18 2. Demonstrated net overall reduction in the annual revenue requirement for the
19 Arizona Properties for the test year compared with Citizens' 1999 operating and
20 capital costs calculated as follows: $(\text{Citizens 1999 Operating Expenses} \times (\text{Test Year Customers} / \text{1999 Customers}) - \text{Test Year Operating Expenses}) + \text{Test Year Net Plant} \times (\text{1999 Cost Factor} - \text{Test Year Cost Factor})$.
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- 1 3. The amount resulting from the revenue requirement comparison in condition two
2 should be multiplied by a factor not less than three nor greater than five to reflect the
3 number of years of savings reasonably anticipated and also service quality
4 considerations.
- 5 4. The result of condition 3 should be divided by two to recognize an equal sharing
6 between stockholders and ratepayers to provide the amount, if any, to be allowed for
7 recovery in rates. The sharing serves to recognize Arizona-American's obligation as
8 a public utility to provide cost efficient service by flowing one-half of the savings
9 through to ratepayers while at the same time recognizing the Company's
10 achievement in providing cost efficient service by allowing stockholders to retain
11 one-half of the savings.

12 RUCO contended that the gain realized by Citizens from the sale should be shared
13 equally between Citizens stockholders and ratepayers. RUCO also suggested that to make
14 this transaction in the public interest, among other things, the transaction should be contingent
15 upon Arizona-American's Board of Director's approving a letter pledging to invest no less than
16 15 percent of the purchase price in acquisitions and capital improvements of "resource
17 stressed" water and/or wastewater utilities in Arizona no later than 72 months after the date the
18 Commission authorizes the transaction. Finally, RUCO argued that Citizens' retention of
19 certain IDRBS, and the elimination of accumulated deferred income tax credits ("ADITs") and
20 investment tax credits ("ITCs") will have a detrimental impact on ratepayers.

21 Analysis of Disposition of Gain Issue

22 RUCO contended that fundamental principles of fairness support sharing the gain in this
23 case. RUCO maintained that ratepayers have shared in the risk associated with the operation
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1 of the utility assets. It necessarily follows that ratepayers should share in the gain realized
2 from the sale of those assets. This Commission has recognized this principle of fairness in
3 situations where there are gains as well as losses.

4 In response, Citizens argued that ratepayers have assumed no risk in connection with
5 the operation of Citizens' water and wastewater utility business. Investors have provided the
6 utility's capital and bear the financial risks associated with its operations. Therefore, argues
7 Citizens, the investors should be entitled to receive any gain resulting from the transaction.

8 We believe, under the circumstances of this case, that gain sharing is appropriate. The
9 issue of gain sharing requires a case-by-case analysis. In the regulatory environment
10 shareholders are insulated from the normal business risks related to utility assets by the
11 regulatory accounting treatment of depreciation. This accounting treatment transfers the risk
12 of the assets becoming obsolete from the shareholders to the ratepayers.

13 The practical impact of such regulatory accounting reduces the risk to Citizens'
14 shareholders and increases the risk to Citizens' ratepayers. Fairness requires that if a gain is
15 to follow risk, Citizens' ratepayers should be permitted to share in the gain.

16 Arizona-American would be conferred a protected, monopoly status should we approve
17 this transaction. Arizona-American's customer base is guaranteed by the transfer, along with
18 the tangible assets that make up its fair value rate base. The existence of a captive ratepaying
19 clientele insures Arizona-American against loss in significant measure. The ratepayers,
20 however, share in the risks undertaken by Arizona-American. Because Arizona-American
21 shoulders less risk, and because the ratepayers shoulder their share of the risk, an equal
22 sharing of the gain is appropriate.

23 An equal sharing of the gain is consistent with our policy of allowing ratepayers to share
24 in gains as well as losses. Undoubtedly, if Citizens' suffered a loss on these assets, which

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1 placed them in financial peril, they would seek a rate increase. There is a rational basis for
2 sharing the gain with ratepayers since Citizens' ratepayers subsidized the appreciation in value
3 of the assets while bearing the economic risk.

4 5 Analysis of Acquisition Adjustment

6 In the Settlement Agreement, Staff and Arizona-American agreed that consideration of
7 an acquisition adjustment should be deferred until a future rate proceeding. RUCO also
8 agreed with this approach, concurring that it is necessary that Arizona-American have an
9 opportunity to demonstrate that the acquisition has provided a net benefit to ratepayers by
10 virtue of improved operating efficiencies, economies of scale and other synergies. RUCO,
11 however, recommended that the Commission adopt criteria for determining the amount of any
12 future acquisition adjustment.

13 It is not in the public interest to expose ratepayers to a potential increase in rate base of
14 \$71.2 million. The need for a definitive limitation at this juncture is necessary when we
15 consider the magnitude of the premium in this case. The premium is slightly less than one-half
16 of net plant and slightly less than one-third of the purchase price. RUCO's criteria and
17 corresponding formula set forth above is fair and reasonable under the circumstances of this
18 case.

19 Analysis of the IDRBs, ADITs and ITCs

20 Arizona-American would assume certain outstanding IDRBs, which total approximately
21 \$10.6 million. The IDRBs that would be assumed constitute low-cost capital. The average
22 cost of the IDRBs that would be assumed by Arizona-American was 3.55 percent per annum
23 during 1999. RUCO believed, but was unable to ascertain, that there may be three additional
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1 Citizens' bond issues, representing low-cost capital, that will not be assumed in connection
2 with the transaction. The total aggregate principal of the three potentially outstanding bonds is
3 \$23.65 million.

4 Arizona-American acknowledged that there have been other bonds that have been
5 issued by Citizens but because of the time frame involved in completing this transaction,
6 coupled with administrative difficulties, it would be infeasible and unreasonable to require
7 Arizona-American to assume or impute these bonds to its capital structure. The additional cost
8 to Arizona-American to replace these low-cost IDRBs with alternative forms of financing was
9 not ascertained. Nonetheless, the evidence shows that it could be in the tens of millions of
dollars.

10 The Settlement Agreement provided that the treatment of ADITs, which totaled
11 approximately \$5.2 million, and Citizens' ITCs, which totaled approximately \$2.2 million, should
12 be deferred until Arizona-American seeks new rates in a future proceeding. RUCO concurred
13 with the Settlement Agreement on this issue, however, requested the Commission to evaluate
14 the impact that these items will have on future rates in determining whether this transaction is
15 in the public interest.

16
17 Analysis of Remaining RUCO Recommendations

18 RUCO recommended that the Commission treat AIACs and CIACs the way it
19 traditionally has treated them. Normally, AIACs are not amortized, and their balance is
20 reduced by the amount of refunds made. Advance Agreements normally provide for annual
21 refunds, and typically the total refunds over the normal ten-year period would be less than the
22 original amount of the advance. The remaining AIAC balance is converted to CIAC and
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1 amortized. The amortization of CIAC is treated as a reduction to Depreciation Expense as well
2 as revenue requirement.

3 RUCO recommended that authorization of the transaction be made contingent on
4 Arizona-American pledging to invest not less than 15 percent of the purchase price for the
5 Acquired Assets, or approximately \$35 million, in acquisitions and capital improvements of
6 "resource stressed" water and/or wastewater utilities in Arizona. These acquisitions and
7 capital improvements would have to be made within 72 months from the date on which the
8 Commission approves the transaction. The Commission acknowledges that some of the
9 detrimental impact on ratepayers as a result of this transaction is not quantifiable. The
10 Commission agrees with RUCO that the impact can be rectified to some degree by a gesture
11 of goodwill on the part of the Company. A commitment by the Company to aid smaller,
12 resource-stressed water companies would benefit Arizona ratepayers and absorb some of the
13 detrimental impact resulting from the transaction.

14 The Commission also recognizes that there are small water and wastewater utilities in
15 Arizona that may need technical and financial assistance. Indeed, the Commission has
16 attempted to provide such assistance to small water and wastewater utilities through
17 workshops and the development of policies aimed at improving their financial viability.

18 Arizona-American has indicated its willingness to work with the Commission in
19 developing solutions to service problems being experienced by small, troubled utilities. By
20 virtue of acquiring Citizens' systems in Arizona, Arizona-American would be in closer proximity
21 to a number of these systems, and the Commission would expect Arizona-American, as
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1 circumstances warrant, seriously considering acquiring these systems or otherwise providing
2 technical or financial assistance.

3
4 Analysis of the Transaction

5 The Settlement Agreement as proposed has several serious flaws, which if approved
6 would not be in the public interest. While certain flaws can be cured, others cannot based on
7 the record. The Commission is unable to ascertain from the record the additional costs
8 associated with alternative forms of financing that Arizona-American's ratepayers would
9 subsidize. The Commission is concerned about the significant upward impact that alternative
10 forms of financing will have on rates. Ratepayers should not be placed in an inferior position
11 as the result of an asset transfer between two regulated utilities. The Commission is also
12 unable to determine the immediate incremental revenue requirement due to the elimination of
13 the ADITs and ITCs. The total amount of ADITs and ITCs eliminated by this transaction is
14 \$7.4 million and while its impact on rates will be addressed in the next rate case, the
15 Commission is concerned about the immediate impact. Some harm cannot be undone, and
16 the Commission is interested in looking at the impact of this transaction prospectively, not
retrospectively.

17 The Commission is also concerned with the manner which the Settlement Agreement
18 treats AIACs and CIACs. The Settlement Agreement addresses the AIAC/CIAC issue by
19 establishing a set percentage (5%) of AIACs, which would be converted to CIACs. This
20 percentage could in reality differ by a substantial amount from the set percentage, which would
21 be converted under our normal treatment of AIACs and CIACs. When we consider that the
22 amount of AIACs in question is \$80 million, the percentage that it differs does not have to be
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1 great to have a substantial detrimental impact on ratepayers. There is also nothing in this
2 record to show why the Commission should treat this issue different from its normal treatment.

3 Finally, the Commission is concerned about the unusually high premium that Arizona-
4 American is paying. The unusually high premium will almost undoubtedly result in a request
5 for increased rates. The Commission typically does not allow for acquisition adjustments, as
6 ratepayers should not be compromised as the result of an asset transfer.

7 For the foregoing reasons, this transaction is not in the public interest. The applicants
8 should either withdraw their application, and/or restructure their application so that it
9 adequately addresses the concerns set forth above.

10 FINDINGS OF FACT

11 1. On March 24, 2000, Citizens and Arizona-American filed with the Commission a
12 joint application for approval of the transfer of Citizens' water and wastewater utility plant and
13 assets in Arizona and the transfer of Citizens' Certificates to Arizona-American.

14 2. RUCO and Arizona Utility Investors Association were authorized to intervene in
15 this proceeding.

16 3. A public notice of the application and hearing was published in various
17 newspapers throughout Arizona within and in the vicinity of Citizens and Arizona-American's
18 service territories.

19 4. Citizens' customers were also notified of the application by means of a written bill
20 insert.

21 5. Public comment was taken on September 14, 2000, in Sun City, Arizona.
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1 6. On September 27, 2000, a hearing was held on this matter at the Commission's
2 offices in Phoenix, Arizona.

3 7. Citizens is engaged in the business of providing water and wastewater utility
4 services at various locations within the State of Arizona.

5 8. Arizona-American, a wholly owned subsidiary of AWW, is currently engaged in
6 providing water utility services to the public in portions of Maricopa County, Arizona.

7 9. AWW and its subsidiaries, including Arizona-American, are the largest privately-
8 owned water utility system in the United States, providing water, wastewater and other water
9 resource management services to approximately 3 million customers in 23 states.

10 10. CCC's current business strategy is to focus on the provision of
11 telecommunication services and to expand its telecommunications subsidiaries' operations
12 through the acquisition of wire centers and access lines from other providers, primarily in rural
13 areas.

14 11. In connection with this business strategy, CCC intends to sell its water and
15 wastewater, electric and natural gas services properties and to utilize the proceeds to finance
16 acquisitions and other business activities in the telecommunications area.

17 12. Citizens, Arizona-American and AWW entered into an asset purchase agreement
18 dated October 15, 1999, under which Arizona-American will acquire all of the water and
19 wastewater assets and the Certificates of Citizens in Arizona.

20 13. The purchase price that would be paid by Arizona-American is approximately
21 \$231 million, including the assumption of approximately \$10.6 million of certain debt in the
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1 form of outstanding IDRBs, subject to adjustment based on plant additions and retirements
2 occurring after June 30, 1999.

3 14. Arizona-American will finance the transaction by a combination of debt and
4 equity, which would result in Arizona-American having a capital structure containing 55 to 60
5 percent debt and 45 to 40 percent common equity, which is comparable to the capital
6 structures of most large, publicly-traded water utilities.

7 15. Staff has recommended that the transfer of Citizens' water and wastewater utility
8 plant and assets and Citizens' Certificates be approved, subject to the following conditions:

- 9 (i) Any decision on the ratemaking treatment of an acquisition adjustment,
10 deferred taxes, excess deferred taxes and investment tax credits should
11 be deferred until a future rate proceeding.
- 12 (ii) Recovery of any acquisition adjustment should be based on Arizona-
13 American's ability to demonstrate that clear, quantifiable and substantial
14 net benefits have been realized by ratepayers, which would not have been
15 realized had the transaction not occurred.
- 16 (iii) Arizona-American should be Ordered to file a report 13 months after the
17 closing of the transaction comparing the number of complaints received by
18 the Commission and providing an explanation of any significant changes
19 in the number and importance of the complaints.
- 20 (iv) An imputation of the benefits related to advances in aid of construction
21 ("AIAC") and contributions in aid of construction ("CIAC") received by
22 Arizona-American should be made in subsequent rate proceedings for
23 each former Citizens' system.
- 24 (v) Arizona-American should be required to seek Commission approval of any
amendments to, or transfers of agreements relating to the purchase of
water, such as Citizens' CAP water subcontracts.
- (vi) Arizona-American should be Ordered to charge ratepayers for services
based on the rates, charges, and service tariffs in effect at the time of
closing in each Citizens' service territory, until such time as Arizona-
American files general rate proceedings for each service territory.

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1 together with its Agua Fria Water Division, Mohave Water Division, Sun City Water Company,
2 Sun City Sewer Company, Sun City West Utilities Company, Citizens Water Services
3 Company of Arizona, Citizens Water Resources Company of Arizona, Havasu Water Company
4 and Tubac Valley Water Company, and Arizona-American Water Company is not approved.

5 IT IS FURTHER ORDERED that the Applicants shall either withdraw their application
6 and/or restructure their application so that it meets the criteria set forth in this Order.

7 IT IS FURTHER ORDERED that the Hearing Division shall issue a procedural Order
8 setting forth a schedule for additional filings and/or hearings in this matter.

9 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

10 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

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13 CHAIRMAN

COMMISSIONER

COMMISSIONER

14 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
15 Secretary of the Arizona Corporation Commission, have
16 hereunto set my hand and caused the official seal of the
17 Commission to be affixed at the Capitol, in the City of
18 Phoenix, this _____ day of _____, 2001.

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BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _____

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