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BEFORE THE ARIZONA CORPORATION COMMISSION  
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WILLIAM A. MUNDELL  
CHAIRMAN  
JIM IRVIN  
COMMISSIONER  
MARC SPITZER  
COMMISSIONER

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IN THE MATTER OF THE JOINT APPLICATION OF 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 NOS. W-01032A-00-0192  
W-01032B-00-0192  
W-01032C-00-0192  
S-02276A-00-0192  
WS-02334A-00-0192  
WS-03454A-00-0192  
WS-03455A-00-0192  
W-02013A-00-0192  
W-01595A-00-0192  
W-01303A-00-0192

DECISION NO. 63584

OPINION AND ORDER

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DATE OF HEARING: September 27, 2000  
PLACE OF HEARING: Phoenix, Arizona  
PRESIDING ADMINISTRATIVE LAW JUDGE: Karen E. Nally<sup>1</sup>  
IN ATTENDANCE: Chairman William A. Mundell and Commissioner Jim Irvin

APPEARANCES: Mr. Michael M. Grant, GALLAGHER & KENNEDY, and Mr. Craig Marks, Associate General Counsel, on behalf of Citizens Communications Company;

<sup>1</sup> This Recommended Opinion and Order was prepared by Administrative Law Judge Marc E. Stern upon review of the testimony and exhibits admitted into evidence in the proceeding.

1 Mr. Norman D. James, FENNEMORE CRAIG, on  
2 behalf of Arizona-American Water Company;

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

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

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

8 **BY THE COMMISSION:**

9 On March 24, 2000, Citizens Utilities Company, now known as Citizens  
10 Communications Company, together with its Agua Fria Water Division, Mohave Water  
11 Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities  
12 Company, Citizens Water Services Company of Arizona, Citizens Water Resources Company of  
13 Arizona, Havasu Water Company and Tubac Valley Water Company (collectively "Citizens"),  
14 and Arizona-American Water Company ("Arizona-American") filed with the Arizona Corporation  
15 Commission ("Commission") a Joint Application to Transfer Assets and Related Approvals  
16 ("Application") of Citizens' water and wastewater utility assets in Arizona including Citizens'  
17 Certificates of Convenience and Necessity ("Certificates") held by Citizens to Arizona-American.

18 On May 17, 2000 and on June 1, 2000, the Residential Utility Consumer Office  
19 ("RUCO") and the Arizona Utility Investors Association ("AUIA") filed applications for leave to  
20 intervene. Subsequently, intervention was granted to RUCO and to AUIA.<sup>2</sup>

21 On May 30, 2000, by Procedural Order, a hearing was scheduled on the above-captioned  
22 matter for September 27, 2000. Citizens and Arizona-American caused public notice of the  
23 Application and hearing thereon to be published in various newspapers throughout Arizona. In  
24

25 <sup>2</sup> On April 10, 2000, Mr. Marvin Lustiger filed an application to intervene in the above-captioned matter.  
26 However, by subsequent filing, Mr. Lustiger clarified that he was only interested in electric or telephone  
service in Mohave County, and therefore, Mr. Lustiger's request to intervene was deemed to have been  
withdrawn.

1 addition, Citizens notified all its customers of the Application by means of a written bill insert.

2 On September 14, 2000, a formal public comment session was held in Sun City.

3 On September 26, 2000, the Commission's Utilities Division ("Staff") filed a Settlement  
4 Agreement ("Agreement") marked Exhibit A which is incorporated by reference and attached  
5 hereto.

6 On September 27, 2000, a full public hearing took place at the offices of the Commission  
7 in Phoenix, Arizona. Citizens, Arizona-American, RUCO, AUIA and Staff were present with  
8 counsel. Following the presentation of evidence, Citizens and RUCO submitted written briefs on  
9 the issue of whether Citizens should be required to pay a portion of the gain resulting from the  
10 sale of its utility assets to Citizens' customers. The matter was then taken under advisement  
11 pending submission of a recommended Opinion and Order to the Commission.

## 12 DISCUSSION

### 13 Parties to the Transaction

14 Citizens, through its various divisions and subsidiaries, provides water, wastewater,  
15 electric, natural gas and telecommunications services to approximately 1.8 million customers in  
16 22 states, including in excess of 100,000 customers in Arizona. Citizens' current business  
17 strategy is to focus on the provision of telecommunications services and the expansion of those  
18 operations through the acquisition of wire centers and access lines from other providers,  
19 primarily in rural areas, as was the case in the recently approved transfer of rural wire centers by  
20 Qwest Corporation to Citizens Utilities Rural Company, Inc.

21 In connection with this business strategy, Citizens intends to sell its water, wastewater,  
22 electric, and natural gas utilities and to apply the proceeds to finance acquisitions and other  
23 business activities in the telecommunications area. In April 2000, Citizens also announced the  
24 sale of its Louisiana natural gas operations for \$375 million.

25 The Commission granted Arizona-American a Certificate of Convenience and Necessity  
26 to provide water service to approximately 4,600 customers in portions of the Town of Paradise

1 Valley, the City of Scottsdale and certain unincorporated portions of Maricopa County. Arizona-  
2 American is a wholly owned subsidiary of American Water Works Company, Inc. ("AWW")  
3 which is the largest privately-owned water utility system in the United States, providing water,  
4 wastewater and other water resource management services to approximately 3 million customers  
5 in 23 states, and with a reported consolidated net plant of \$5.1 billion and operating revenues of  
6 \$1.26 billion. AWW's December 31, 1999, balance sheet reflected a capital structure of 58.4  
7 percent long-term debt, 2.3 percent preferred stock and 39.3 percent common equity.

8 In 1999, AWW's subsidiaries invested \$467 million in improving and upgrading their  
9 facilities, and for the past several years, AWW has made similar expenditures averaging nearly  
10 \$400 million per year. According to AWW witnesses, AWW's acquisition policy is motivated,  
11 at least in part, by anticipated capital expenditures resulting from new regulatory requirements  
12 and programs and the need to replace or upgrade aged infrastructure to maintain high quality  
13 service. With the additional water and wastewater systems, AWW and its subsidiaries hope to  
14 obtain economies of scale and to strengthen their financial capability by expanding their  
15 customer base.

16 The Transaction

17 On October 15, 1999, Citizens, Arizona-American and AWW entered into an agreement  
18 under which Arizona-American is to acquire the water and wastewater assets and the Certificates  
19 held by Citizens in Arizona ("the Acquired Assets") for approximately \$231 million, subject to  
20 adjustment at the time of closing. The purchase price will be increased based on utility plant  
21 added by Citizens after June 30, 1999, and will be reduced based on plant retirements occurring  
22 after such date. The Acquired Assets include all utility plant, property and interests relating to  
23 Citizens' water and wastewater operations in Arizona, with certain exceptions, including assets  
24 commonly used by Citizens in connection with other utility operations, cash and cash  
25 equivalents, and assets related to benefit plans. Citizens will also retain certain liabilities,  
26 including obligations for taxes payable, obligations relating to employee compensation and

1 benefits, and refunds of certain advances in aid of construction. Arizona-American will assume  
2 and be liable for all contracts and permits assigned at closing, certain Industrial Development  
3 Revenue Bonds ("IDRBs"), and unperformed obligations.

4 Arizona-American will finance the purchase of the Acquired Assets by a combination of  
5 debt and equity. AWW has recently formed a new subsidiary, American Water Capital  
6 Corporation ("AWCC"), that will provide loans and other financial services to AWW  
7 subsidiaries. Initially, Arizona-American will borrow funds from AWCC on a short-term basis,  
8 and receive additional funds in the form of common equity directly from AWW. Within 12  
9 months, the short-term debt will be converted to long-term debt with a planned capital structure  
10 which will contain 55 to 60 percent debt and 45 to 40 percent common equity, including  
11 Arizona-American's existing debt and equity capital and the Citizens' IDRBs that will be  
12 assumed.<sup>3</sup>

### 13 The Position of Staff and the Staff Settlement Agreement

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

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

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

23 Third, Staff recommended that Arizona-American should be ordered to file, 13 months  
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25 <sup>3</sup> Arizona-American has filed an application for authority to issue short-term and long-term debt in  
26 connection with financing the purchase of the Acquired Assets, which is pending in Docket No. W-  
01303A-00-0929.

1 after the closing of the transaction, a report comparing the number of complaints received by the  
2 Commission prior to and after the transaction. The report should provide an explanation of any  
3 significant changes in the number and importance of the complaints. Staff would then review  
4 this report and, if necessary, make a recommendation to the Commission of any further action to  
5 be taken.

6 Fourth, Staff recommended that an imputation of the benefits related to advances in aid  
7 of construction ("AIAC") and contributions in aid of construction ("CIAC") received by  
8 Arizona-American be made in subsequent rate proceedings for each former Citizens' system.  
9 The purpose of the imputation would be to recognize those portions of the Acquired Assets that  
10 were financed by AIAC and CIAC which Arizona-American will not be assuming. Staff also  
11 recommended that imputed AIAC be amortized over a period of 10 years, while imputed CIAC  
12 would be amortized below the line in the same manner as would have otherwise occurred.

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

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

20 In its rebuttal filing, Arizona-American indicated that it would stipulate to the conditions  
21 recommended by Staff, including the deferral of a decision concerning the recognition of an  
22 acquisition adjustment and the conditions under which an acquisition adjustment would be  
23 recognized, and would adopt and utilize the rates and charges for service, and all other service  
24 tariffs currently in effect in each of the affected Citizens service territories. However, Arizona-  
25 American disagreed with imputing Citizens' AIAC and CIAC to Arizona-American.

26

1           Subsequently, Staff and Arizona-American entered into the Agreement, which resolved  
2 all areas of disagreement relating to the terms and conditions under which the Acquired Assets  
3 would be transferred to Arizona-American.

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

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

23           Based on these agreements by Arizona-American, Staff is recommending that the  
24 Commission should approve the transfer of the Acquired Assets to Arizona-American and should  
25 not impose any additional terms, conditions or requirements on Arizona-American.

26

1           During the hearing, Staff and Arizona-American voiced their support of the Agreement,  
2 believing that its terms are reasonable and in the public interest. AUIA also expressed its  
3 support for the Agreement. However, the remaining party to the proceeding, RUCO, objects to  
4 the approval of the Agreement and to the transaction generally, as discussed below.

5 Position of RUCO

6           RUCO maintains the proposed transaction believing that it is not in the public interest  
7 and should not be approved unless it is restructured. RUCO argued that the transaction could  
8 possibly, in the future, impact on ratepayers. While RUCO did not disagree that consideration of  
9 an acquisition adjustment should be deferred until a future ratecase, RUCO argued that the gain  
10 resulting from the sale of the Acquired Assets received by Citizens, i.e., the difference between  
11 the net book value of the Acquired Assets and the purchase price being paid by Arizona-  
12 American, should be shared equally between Citizens stockholders and the ratepayers. RUCO  
13 further argued that the Commission should adopt a set of criteria to determine what, if any,  
14 acquisition adjustment should be allowed in a future rate proceeding. RUCO also suggested that  
15 to make this transaction in the public interest, among other things, the transaction should be  
16 contingent upon Arizona-American's Board of Director's approving a letter pledging to invest no  
17 less than 15 percent of the purchase price in acquisitions and capital improvements of "resources  
18 stressed" water and/or wastewater utilities in Arizona no later than 72 months after the date the  
19 Commission authorizes the transaction.

20 Analysis of Disposition of Gain Issue

21           RUCO contended that fundamental principles of fairness support sharing the gain in this  
22 case. RUCO maintained that ratepayers have shared in the risk associated with the operation of  
23 the utility assets and that it necessarily follows that ratepayers should share in the gain realized  
24 from the sale of those assets. According to RUCO, this risk sharing results from the accounting  
25 treatment provided in the National Association of Regulatory Utility Commissioners  
26 ("NARUC") Uniform System of Accounts when an asset is retired prematurely, i.e., before a

1 utility fully recovers its original cost via depreciation. RUCO also stated that prior Commission  
2 decisions support gain sharing.

3 In response, Citizens argued that ratepayers have assumed no risk in connection with the  
4 operation of Citizens' water and wastewater utility business. Investors have provided the  
5 utility's capital and bear the financial risks associated with its operations. Therefore, the  
6 investors should be entitled to receive any gain resulting from the transaction. As to prior  
7 Commission decisions, Citizens cited three analogous cases involving a sale of an entire line of  
8 utility business in which the Commission did not order gain sharing.<sup>4</sup> Citizens also cited  
9 Decision No. 60167 (April 17, 1997) in which a utility's natural gas business was sold at a loss.  
10 In that case, the Commission did not order the customers to share in the loss.<sup>5</sup>

11 This proceeding is similar to the three cases cited earlier by Citizens since it is selling its  
12 entire business and will have no further water and wastewater operations in Arizona. The  
13 Commission has never required gain sharing under these circumstances. In the Contel of the  
14 West matter, in which Citizens was authorized to acquire all of Contel's telephone properties in  
15 Arizona, Staff urged that the gain resulting from the sale be shared equally with ratepayers.  
16 However, the Commission rejected gain sharing in that case.

17 We also do not believe that ratepayers bear a substantial risk by virtue of receiving utility  
18 service in this case. The particular accounting treatment for depreciable plant provided under the  
19 Uniform System of Accounts does not shift risk to customers, but rather prescribes particular  
20 accounting adjustments to properly reflect rate base before and after the retirement of a plant  
21 item. The utility's owners, i.e., its shareholders, ultimately bear the risks associated with the  
22 utility's business. While regulation may reduce those risks relative to most non-regulated  
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25 <sup>4</sup> Citizens/Southern Union, Decision No. 57647 (December 2, 1991); Contel/Citizens, Decision No. 58819,  
(October 17, 1994); and GTE/Citizens, Decision No. 62648 (June 13, 2000).

26 <sup>5</sup> Ajo Improvement Company/Southwest Gas, Decision No. 60167 (April 17, 1997).

1 businesses, regulation does not shift that risk to ratepayers, who are entitled to receive utility  
2 service at rates set by the Commission.

3 Accordingly, we do not find it appropriate under the circumstances in this case to require  
4 Citizens to share with ratepayers any part of the gain it receives from the sale of the Acquired  
5 Assets to Arizona-American. However, this will not preclude the Commission from protecting  
6 the ratepayers in the future. In any claim for an acquisition adjustment in a future rate case, the  
7 Commission can strictly scrutinize the foundation of the claim and determine what amount, if  
8 any, should be approved.

9 Analysis of Remaining RUCO Recommendations

10 RUCO's other recommendations pertained to the structure of the transaction and  
11 RUCO's concerns that this structure could lead to rate increases in the future. RUCO's concern  
12 primarily relates to the fact that Arizona-American will not be assuming all of Citizens'  
13 liabilities associated with AIAC and CIAC, which totaled approximately \$80.8 million and \$4.7  
14 million, respectively, at December 31, 1999. According to RUCO, the structure of the  
15 transaction will result in the elimination of AIAC and CIAC as reductions from rate base, which  
16 will in turn result in an increase in rate base and, eventually, to rate increases.

17 We believe that the Agreement appropriately deals with this issue. Citizens' AIAC and  
18 CIAC will be recognized for ratemaking purposes by Arizona-American, even though Arizona-  
19 American is not assuming those liabilities. By virtue of this imputation, the impact of the  
20 structure of the transaction will be ameliorated. Based on the evidence and the testimony, the  
21 approach utilized in the Agreement is reasonable.

22 Further, the evidence indicates that the transaction between Citizens, Arizona-American  
23 and AWW was the product of arms-length negotiations that occurred after Citizens had adopted  
24 its current business strategy of focusing on telecommunications services and divesting itself of  
25 its water and wastewater systems, as well as its electric and natural gas systems throughout the  
26

1 country. . This is not a transaction between affiliated companies. The payment by Arizona-  
2 American will constitute an investment in the Acquired Assets.

3 RUCO also expressed concern regarding the impact of the transaction on Citizens'  
4 accumulated deferred income taxes ("ADITs"), which totaled approximately \$5.2 million as of  
5 December 31, 1999, and Citizens' investment tax credits ("ITCs"), which totaled approximately  
6 \$2.2 million as of the same date. Under the Agreement, any decision on the treatment of ADITs  
7 and ITCs will be deferred until Arizona-American seeks new rates in a future proceeding.  
8 Staff's recommendation is appropriate under the circumstances herein.

9 Next, RUCO questioned the approach proposed by Arizona-American and Staff, as  
10 adopted in the Agreement, for dealing with the possible future recognition of an acquisition  
11 adjustment in rates. RUCO agreed with Arizona-American and Staff that it is appropriate to  
12 defer consideration of any acquisition adjustment resulting from the transaction until a future rate  
13 proceeding, in order to afford Arizona-American an opportunity to demonstrate that the  
14 acquisition has provided a net benefit to ratepayers by virtue of improved operating efficiencies,  
15 economies of scale and other synergies. However, RUCO's witnesses also contended that the  
16 Commission should adopt a set formula that would be used in connection with any future  
17 determination of the amount of the acquisition adjustment.

18 We have concerns about the adoption of a set, mechanical formula to quantify a future  
19 acquisition adjustment. We believe that such a determination should be made at the time all the  
20 facts and circumstances are known. Staff's recommendation concerning the basis on which the  
21 Commission will allow the recovery of an acquisition adjustment is reasonable and in the public  
22 interest. Arizona-American is cautioned that the Commission will require Arizona-American to  
23 demonstrate that clear, quantifiable and substantial net benefits to ratepayers have resulted from  
24 the acquisition of Citizens' systems that would not have been realized had the transaction not  
25 occurred before the Commission will consider recovery of any acquisition adjustment in a future  
26 rate proceeding.

1 RUCO was also critical of Arizona-American's failure to assume all of Citizens' IDRBs.  
2 As stated, Arizona-American will assume certain IDRBs, which total approximately \$10.6  
3 million. The IDRBs that will be assumed constitute low-cost capital. The average cost of the  
4 IDRBs that will be assumed by Arizona-American was 3.55 percent per annum during 1999.  
5 RUCO believes that there may be three additional Citizens bond issues, representing low-cost  
6 capital, that will not be assumed in connection with the transaction.

7 Arizona-American, in its testimony, has acknowledged that other bonds have been issued  
8 by Citizens. The evidence indicates, however, that in contrast to the IDRBs that will be  
9 assumed, the other bonds would require unanimous consent from all bond holders in order to be  
10 assumed, which would be administratively difficult, if not impossible, to accomplish within the  
11 time frame of the transaction. The additional costs to Arizona-American to replace these low-  
12 cost IDRBs with alternative forms of financing was not ascertained.

13 We find that it would not be feasible for Arizona-American to assume the remaining  
14 bonds and it would not be reasonable to impute these bonds to Arizona-American's capital  
15 structure. The remaining bonds will continue to be an obligation of Citizens and will continue to  
16 be included in Citizens' capital structure in its ongoing telecommunications business.

17 Finally, RUCO recommends that authorization of the transaction be made contingent on  
18 Arizona-American pledging to invest not less than 15 percent of the purchase price for the  
19 Acquired Assets, or approximately \$35 million, in acquisitions and capital improvements of  
20 "resource stressed" water and/or wastewater utilities in Arizona. These acquisitions and capital  
21 improvements would have to be made within 72 months from the date on which the Commission  
22 approves the transaction.

23 The Commission recognizes that there are small water and wastewater utilities in Arizona  
24 that may need technical and financial assistance. Indeed, the Commission has provided such  
25 assistance to small water and wastewater utilities through workshops and the development of  
26 policies aimed at improving their financial viability. However, it is not reasonable to compel a

1 private utility to spend in excess of \$35 million to solve these problems, nor is it clear that the  
2 Commission has the authority to do so.

3 Arizona-American has indicated its willingness to work with the Commission in  
4 developing solutions to service problems being experienced by small, troubled utilities. By  
5 virtue of acquiring Citizens' systems in Arizona, Arizona-American will be in closer proximity  
6 to a number of these systems, and the Commission would expect Arizona-American, as  
7 circumstances warrant, to seriously consider acquiring these systems or otherwise provide  
8 technical or financial assistance. For these reasons, we do not believe it is appropriate to impose  
9 such a mandate on Arizona-American.

10 \* \* \* \* \*

11 Having considered the entire record herein and being fully advised in the premises, the  
12 Commission finds, concludes, and orders that:

13 **FINDINGS OF FACT**

14 1. Pursuant to authority granted by the Commission, Citizens provides public water,  
15 wastewater, electric, natural gas and telecommunications services in various parts of Arizona.

16 2. Pursuant to authority by the Commission, Arizona-American, a wholly owned  
17 subsidiary of AWW, provides public water service to approximately 4,600 customers in the  
18 Town of Paradise Valley, the City of Scottsdale and in certain unincorporated portions of  
19 Maricopa County, Arizona. Arizona-American is presently classified as a Class B water utility.

20 3. On March 24, 2000, Citizens and Arizona-American filed an Application  
21 requesting approval of the sale and transfer of Citizens' water and wastewater utility assets in  
22 Arizona together with the transfer of Citizens' Certificates to Arizona-American.

23 4. RUCO and the AUIA were granted intervention in this Docket.

24 5. Public notice of the Application and hearing thereon was published in various  
25 newspapers throughout Arizona within and in the vicinity of Citizens' and Arizona-American's  
26 certificated service areas.

1           6.       Customers of Citizens were also notified of the Application by means of a written  
2 bill insert.

3           7.       Citizens' current business strategy is to focus on the provision of  
4 telecommunication services and to expand its telecommunications subsidiaries' operations  
5 through the acquisition of wire centers and access lines from other providers, primarily in rural  
6 areas.

7           8.       In the furtherance of this business strategy, Citizens is selling its water,  
8 wastewater, electric and natural gas utilities and applying the proceeds to finance acquisitions  
9 and other business activities in the telecommunications industry.

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

13          10.      AWW is financially sound, and has the experience, expertise and resources to  
14 assume and perform Citizens' public service obligations.

15          11.      On October 15, 1999, Citizens, Arizona-American and AWW entered into an  
16 asset purchase agreement under which Arizona-American will acquire all of the water and  
17 wastewater utility assets together with the requisite Certificates held by Citizens in Arizona.

18          12.      Arizona-American will pay a purchase price of approximately \$231 million which  
19 includes the assumption of approximately \$10.6 million of existing debt in the form of  
20 outstanding IDRBs. The purchase price is subject to adjustment either higher or lower based on  
21 plant additions and retirements occurring after June 30, 1999.

22          13.      Arizona-American will finance the transaction through a combination of debt and  
23 equity, resulting in Arizona-American having a capital structure of 55 to 60 percent debt and 45  
24 to 40 percent common equity. This debt to equity ratio is comparable to the capital structures of  
25 most large, publicly-traded water utilities.

26

1           14. Staff is recommending that the Application be approved for the sale and transfer  
2 of Citizens' water and wastewater utility assets including the Certificates to Arizona-American  
3 subject to the following conditions:

- 4           • that any decision on the ratemaking treatment of an acquisition adjustment,  
5 deferred taxes, excess deferred taxes and investment tax credits be deferred until a  
6 future rate proceeding;
- 7           • that if recovery of any acquisition adjustment is authorized in the future it should  
8 be based on Arizona-American's ability to demonstrate that clear, quantifiable  
9 and substantial net benefits have been realized by ratepayers in the affected areas,  
10 which would not have been realized had the transaction not occurred;
- 11           • that Arizona-American file, 30 days after the first anniversary of the transaction, a  
12 report which compares the number of complaints received by the Commission  
13 under Citizens' ownership and under Arizona-American's ownership and provide  
14 an explanation of any significant changes in the number and importance of the  
15 complaints received. Staff should review the data and, if necessary, make a  
16 recommendation to the Commission of any further action to be taken;
- 17           • that an imputation of the benefits related to AIAC and CIAC received by Arizona-  
18 American should be made in subsequent rate proceedings for each former  
19 Citizens system as recommended by Staff in its direct testimony;
- 20           • that Arizona-American shall be required to secure prior Commission approval of  
21 any amendments to, or transfers of agreements relating to the purchase of water,  
22 such as Citizens' CAP water subcontracts; and
- 23           • that Arizona-American shall charge ratepayers for services based on the rates,  
24 charges, and service tariffs in effect at the time of closing in each Citizens service  
25 territory, until such time as Arizona-American files general rate proceedings for  
26 each service territory.

19           15. On September 26, 2000, Staff filed the Agreement that is marked Exhibit A. The  
20 Agreement resolves all issues relating to the terms and conditions under which the Acquired  
21 Assets may be sold and transferred to Arizona-American.

22           16. In the Agreement, Arizona-American acknowledged that it will follow Staff's  
23 recommendations if they are adopted by the Commission.

24           17. While RUCO did not oppose the treatment of the acquisition adjustment in a  
25 future rate proceeding, it neither joined in signing the Agreement nor suggested a workable  
26

1 alternative approach to that agreed upon by Arizona-American and Staff in the Agreement in this  
2 instance based on our prior treatment of similar transactions.

3 18. Arizona-American is a fit and proper entity to acquire Citizens' utility assets and  
4 Certificates and to assume Citizens' public service obligations for the operation of the utility  
5 systems in Arizona.

6 19. Staff and Arizona-American believe that the approval of the Agreement attached  
7 hereto as Exhibit A is in the public interest.

8 20. Based on our review of the evidence, Staff's recommendations in Findings of Fact  
9 No. 14 and the Agreement are reasonable and in the public interest. Therefore, the transfer of  
10 Citizens' water and wastewater utility assets and Certificates to Arizona-American should be  
11 approved.

#### 12 CONCLUSIONS OF LAW

13 1. Citizens and Arizona-American are public service corporations within the  
14 meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-281, 40-282 and 40-285.

15 2. The Commission has jurisdiction over Citizens and Arizona-American and over  
16 the subject matter of the Application.

17 3. Citizens and Arizona-American provided notice of this proceeding in accordance  
18 with the law.

19 4. There is a continuing need for public water and wastewater service in the  
20 certificated service areas of Citizens.

21 5. Arizona-American is a fit and proper entity to receive the Certificates of Citizens.

22 6. The Application of Citizens and Arizona-American, the Agreement and the  
23 conditions recommended by Staff in Findings of Fact No. 14 should be approved.  
24  
25  
26



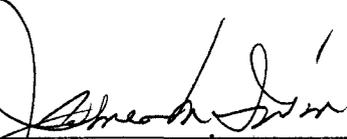
1 IT IS FURTHER ORDERED that Arizona-American Water Company shall continue to  
2 charge the existing rates and charges of the transferred utility companies until further Order by  
3 the Commission.

4 IT IS FURTHER ORDERED that Arizona-American Water Company shall continue to  
5 file all periodic reports, and comply with all outstanding compliance matters previously required  
6 of Citizens Utilities Company, now known as Citizens Communications Company relative to the  
7 acquired water and wastewater operations.

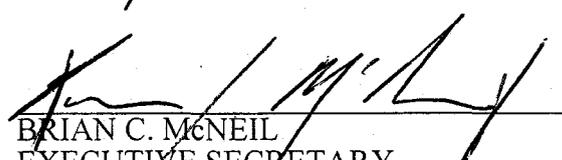
8 IT IS FURTHER ORDERED that Citizens Utilities Company shall maintain its books  
9 and records for the transferred utility companies for a period of 5 years from the effective date of  
10 this Decision.

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

12 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

13   
14   
15   
CHAIRMAN COMMISSIONER COMMISSIONER

16 IN WITNESS WHEREOF, I, BRIAN C. McNEIL,  
17 Executive Secretary of the Arizona Corporation  
18 Commission, have hereunto set my hand and caused the  
19 official seal of the Commission to be affixed at the Capitol,  
20 in the City of Phoenix, this 24<sup>TH</sup> day of  
April, 2001

21   
22 BRIAN C. McNEIL  
23 EXECUTIVE SECRETARY

24 DISSENT \_\_\_\_\_

25  
26

1 SERVICE LIST FOR:

CITIZENS COMMUNICATIONS COMPANY  
ET AL.

2 DOCKET NOS.:

W-01032A-00-0192; W-01032B-00-0192; W-  
01032C-00-0192; S-02276A-00-0192; WS-  
02334A-00-0192; WS-03454A-00-0192; WS-  
03455A-00-0192; W-02013A-00-0192; W-01595A-  
00-0192; and W-01303A-00-0192

3  
4  
5  
6 Michael M. Grant  
7 GALLAGHER & KENNEDY  
8 2575 East Camelback Road  
9 Phoenix, Arizona 85016-9225  
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11 Company, et al.

12 Norman D. James  
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14 3003 N. Central Avenue, Suite 2600  
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16 Attorneys for Arizona-American Water Company

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21 Christopher C. Kempley, Chief Counsel  
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Phoenix, AZ 85004

3099-0035/898296

1 CARL J. KUNASEK  
CHAIRMAN  
2 JIM IRVIN  
COMMISSIONER  
3 WILLIAM A. MUNDELL  
COMMISSIONER  
4

5 BEFORE THE ARIZONA CORPORATION COMMISSION

6 IN THE MATTER OF THE JOINT  
APPLICATION OF CITIZENS UTILITIES  
7 COMPANY; AGUA FRIA WATER  
DIVISION OF CITIZENS UTILITIES  
8 COMPANY; MOHAVE WATER DIVISION  
OF CITIZENS UTILITIES COMPANY; SUN  
9 CITY WATER COMPANY; SUN CITY  
SEWER COMPANY; SUN CITY WEST  
10 UTILITIES 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 UTILITY  
14 ASSETS AND THE TRANSFER OF THEIR  
CERTIFICATES OF PUBLIC CONVENIENCE  
15 AND NECESSITY TO ARIZONA-  
AMERICAN WATER COMPANY AND FOR  
16 CERTAIN RELATED APPROVALS.

DOCKET NOS. W-01032A-00- 0192  
W-01032B-00- 0192  
W-01032C-00- 0192  
S-02276A-00- 0192  
WS-02334A-00-0192  
WS-03454A-00-0192  
WS-03455A-00-0192  
W-02013A-00- 0192  
W-01595A-00- 0192  
W-01303A-00- 0192

SETTLEMENT AGREEMENT BETWEEN  
ARIZONA CORPORATION  
COMMISSION STAFF AND ARIZONA-  
AMERICAN WATER COMPANY

17 On March 24, 2000, Citizens Utilities Company (now known as Citizens'  
18 Communications Company), its Agua Fria Water Division, its Mohave Water  
19 Division, Sun City Water Company, Sun City Sewer Company, Sun City West  
20 Utilities Company, Citizens Water Services Company of Arizona, Citizens Water  
21 Resources Company of Arizona, Havasu Water Company and Tubac Valley Water  
22 Company (collectively, "Citizens") and Arizona-American Water Company  
23 ("Arizona-American") filed with the Arizona Corporation Commission  
24 ("Commission") a joint application for the approval of the sale and transfer of  
25 Citizens water and wastewater utility plant, property and assets in Arizona,  
26 including transfer of Citizens' certificates of convenience and necessity

1 ("Certificates"), to Arizona-American pursuant to A.R.S. § 40-285.

2 The Commission's Utilities Division Staff ("Staff") has investigated the  
3 application and has recommended that the application be approved by the  
4 Commission, subject, however, to certain conditions and requirements, which are  
5 set forth in the Direct Testimony of Linda A. Jaress, filed in this docket on August  
6 14, 2000, at pages 18-19 ("Staff Recommendations"). Arizona-American has  
7 indicated that it is willing to accept the Staff Recommendations, with the exception  
8 of the recommendation that Citizens' advances in aid of construction ("AIAC") and  
9 contributions in aid of construction ("CIAC") be imputed to Arizona-American.

10 Representatives of Staff and Arizona-American have had discussions  
11 concerning the matters in dispute with respect to the application and have reached  
12 a settlement. The purpose of this Settlement Agreement is to memorialize the  
13 agreement that has been made by and among Staff and Arizona-American, which  
14 resolves all areas of disagreement relating to the terms and conditions under which  
15 Citizens' Arizona water and wastewater assets and Citizens' Certificates may be  
16 transferred to Arizona-American.

17 1. AIAC Imputation; Amortization. As of December 31, 1999, Citizens'  
18 AIAC balance was \$80,818,669. Citizens' AIAC balance as of the date on which  
19 Citizens' water and wastewater assets and Certificates are transferred to Arizona-  
20 American and Arizona-American becomes responsible for the provision of water  
21 and wastewater services will be imputed to Arizona-American. Such imputation  
22 shall be solely for ratemaking purposes. The total amount of AIAC imputed will be  
23 adjusted as more particularly provided below. The adjusted amount of AIAC will be  
24 amortized below the line (i.e., no impact on expenses) over a period of 6.5 years,  
25 with the amortization period beginning on the day on which the transfer takes  
26 place.

1           2.    CIAC Imputation; Amortization. As of December 31, 1999, Citizens'  
2 CIAC balance was \$4,734,430. Citizens' CIAC balance as of the date on which  
3 Citizens' water and wastewater assets and Certificates are transferred to Arizona-  
4 American and Arizona-American become responsible for the provision of water and  
5 wastewater services will also be imputed to Arizona-American. Such imputation  
6 shall be solely for ratemaking purposes. The total amount of CIAC to be imputed  
7 to Arizona-American will also be adjusted as provided below. The adjusted CIAC  
8 balance imputed to Arizona-American will be amortized above the line (i.e., as a  
9 reduction to depreciation expense) over a period of 10 years, with the amortization  
10 period beginning on the day on which the transfer takes place.

11           3.    Adjustment to Recorded AIAC and CIAC Balances. The amounts of  
12 AIAC and CIAC to be imputed to Arizona-American for ratemaking purposes will be  
13 based on the actual balances shown on Citizens' regulatory books as of the date of  
14 the transfer, adjusted as follows: An amount equal to five percent (5%) of  
15 Citizens' AIAC balance at the time of the transfer will be reclassified as CIAC and  
16 added to the CIAC balance, and the same amount will be deducted from Citizens'  
17 AIAC balance in computing the amounts to be imputed to Arizona-American for  
18 ratemaking purposes hereunder.

19           4.    Adoption of Remaining Staff Recommendations. Arizona-American  
20 agrees that the Commission may adopt the remaining Staff Recommendations, as  
21 set forth in the Direct Testimony of Linda A. Jaress.

22           5.    Deferral of Determination of Amortization Method. The parties agree  
23 that Arizona-American's request for an accounting order to establish the  
24 amortization method for any acquisition adjustment resulting from the transaction  
25 should be deferred until a future rate case.

26           6.    Transfer in the Public Interest. Based on the foregoing agreements

1 and understandings, Staff agrees that Arizona-American is a fit and proper entity to  
2 acquire the Certificates and that the Commission should authorize and approve the  
3 transfer of Citizens' Arizona water and wastewater assets to Arizona-American on  
4 the terms set forth herein. No additional terms, conditions or requirements are  
5 necessary or appropriate.

6       7.    Support and Defend. This Settlement Agreement will be introduced as  
7 an exhibit during the hearing on the application, presently set for September 27,  
8 2000. Arizona-American and Staff will jointly request that the Settlement  
9 Agreement be received into evidence, and agree to support and defend this  
10 Settlement Agreement and the transfer of Citizens' water and wastewater assets  
11 and the Certificates to Arizona-American on the terms set forth herein as just,  
12 reasonable and appropriate based on the particular circumstances presented in this  
13 application.

14       8.    Compromise; No Precedent. This Settlement Agreement represents a  
15 compromise in the positions of the parties hereto. By entering into this Settlement  
16 Agreement, neither Staff nor Arizona-American acknowledges the validity or  
17 invalidity of any particular method, theory or principle of regulation, or agrees that  
18 any method, theory or principle of regulation employed in reaching a settlement is  
19 appropriate for resolving any issue in any other proceeding, including (without  
20 limitation) any issues that are deferred to a subsequent rate proceeding. Except as  
21 specifically agreed upon in this Settlement Agreement, nothing contained herein  
22 will constitute a settled regulatory practice or other precedent.

23       9.    Privileged and Confidential Negotiations. All negotiations and other  
24 communications relating to this Settlement Agreement are privileged and  
25 confidential, and no party is bound by any position asserted during the  
26 negotiations, except to the extent expressly stated in this Settlement Agreement.

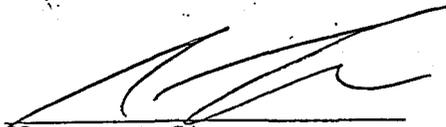
1 As such, evidence of statements that were made or other conduct occurring during  
2 the course of the negotiation of this Settlement Agreement is not admissible in any  
3 proceeding before the Commission or a court.

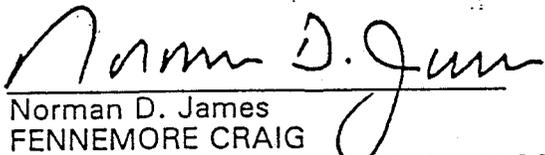
4 10. Complete Agreement. This Settlement Agreement represents the  
5 complete agreement of the parties with respect to its subject matter. There are no  
6 understandings or commitments other than those expressly set forth herein.

7 DATED this 26 day of September, 2000.

8 ARIZONA CORPORATION  
9 COMMISSION STAFF

ARIZONA-AMERICAN WATER COMPANY

10  
11 By:   
12 Steven M. Olea  
13 Acting Director, Utilities Division  
14 Arizona Corporation Commission  
15 1200 West Washington Street  
16 Phoenix, Arizona 85007

17 By:   
18 Norman D. James  
19 FENNEMORE CRAIG  
20 3003 N. Central Avenue, Suite 2600  
21 Phoenix, Arizona 85012-2913  
22 Attorneys for Arizona-American  
23 Water Company

24 An original and 10 copies of the  
25 foregoing was delivered this  
26 \_\_\_ day of September, 2000, to:

Docket Control  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, AZ 85007

A copy of the foregoing  
was delivered this \_\_\_ day of  
September, 2000, to:

Karen E. Nally  
Assistant Chief Administrative  
Law Judge  
Hearing Division  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, AZ 85007

1 A copy of the foregoing  
2 was telecopied/delivered and mailed this \_\_\_\_\_  
3 day of September, 2000, to:

4 Daniel W. Pozefsky  
5 Staff Attorney  
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7 2828 North Central Avenue  
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10 (602) 285-0350  
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15 (602) 254-4300

16 Craig A. Marks  
17 Associate General Counsel  
18 Citizens Communications Company  
19 2901 N. Central, Suite 1660  
20 Phoenix, AZ 85012  
21 (602) 265-3415

22 By: \_\_\_\_\_  
23  
24  
25  
26