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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE COMMISSION'S GENERIC EVALUATION OF THE REGULATORY IMPACTS FROM THE USE OF NON-TRADITIONAL FINANCING ARRANGEMENTS BY WATER UTILITIES AND THEIR AFFILIATES.	Docket No. W-00000C-06-0149

RUCO'S COMMENTS

On June 2, 2006, the Utilities Division ("Staff") issued a letter requesting comments on the appropriate regulatory treatment of several of what it characterized as "non-traditional financings." These comments are the Residential Utility Consumer Office's ("RUCO") response to that request.

1. What is the preferred regulatory treatment for each of the following financing arrangements?

- **a. A developer purchases a non-regulated parent company's non-voting stock. Each of the non-voting shares has a par value of $1.00, is not eligible for dividends, is partially refundable and can be repurchased (subject to certain conditions) by the non-regulated parent for one cent ($0.001) (*sic*). The parent company subsequently contributes the funds to an ACC regulated subsidiary water utility as additional paid-in capital.**
- **b. A developer purchases a regulated utility's non-voting stock and that utility invests those funds in plant. The utility records equity for the proceeds. Neither refundable advances in aid of construction nor contributions in aid of construction are recorded.**
- **c. A developer or a Municipal Government pays a fee for services provided by a non-regulated parent company for services typically covered by "Off-site Hook-up Fees" collected by regulated water and wastewater utilities. Then the**

parent company invests the proceeds in the regulated utility which is recorded as equity by the utility.

As an overview to all three subparts of this question, RUCO identifies two somewhat separate issues that are raised by each scenario. First, is the question of whether the books of the utility should reflect an equity investment arising from the direct or indirect cash infusion. The second issue is whether the utility has utilized appropriate mechanisms to finance the plant it places in service. The ultimate investment of equity into a utility by a developer may create an incentive for the utility to use that equity to finance plant, rather than using advances or contributions, but the appropriateness of using equity rather than advances or contributions is not dependent on what entity provided an equity investment. In scenarios 1A and 1B, RUCO believes that the books of the utility would reflect an equity investment arising from the indirect (in 1A) or direct (in 1B) investment by the developer. However, the fact that it was a developer that provided the funding does not dictate the appropriate regulatory treatment of whether the utility should utilize advances or contributions from a developer to fund a portion of its plant. That question must be answered on a case-by-case basis. The Commission has not established a fixed percentage of plant that ought to be supported by advances or contributions in all cases, but it has approved rate bases that included advances or contributions of approximately 20-25 percent. Thus, for questions 1A and 1B, RUCO believes that the books of the utility would reflect an equity investment, but that the determination of whether the financing of plant was appropriately balanced between debt, equity, advances and contributions would be determined based on a broader understanding of the facts than the question presents, and on a case-by-case basis.

As to question 1C, RUCO cannot provide a specific answer because it cannot accept the premise of the question that there are "services typically covered by 'Off-site Hook-up

Fees' collected by regulated water and wastewater utilities." Many water and wastewater utilities do not have hook-up fees and thus it cannot be said that particular services are typically funded by such fees. The determination of appropriate ratemaking treatment in the case of a developer or municipal government paying a fee for services provided by the non-regulated parent of a utility could only be determined based on an understanding of what services are being provided by that parent. To the extent the services the parent provides to the developer/municipal government are beyond those that are the obligation of a regulated utility, the payment of such an amount may be considered earned income when remitted to the parent from the developer/government entity. In this case, such monies would be equity. The determination of the appropriate ratemaking treatment would be dependent (as discussed for 1A and 1B) on an analysis of the balance the utility ultimately struck in its utilization of debt, equity, advances and contributions to finance its assets.

2. What is the maximum percentage of refundable "Advances in Aid of Construction" ("AIAC") appropriate as a percentage of total capital for a private or investor owned water utility?

3. What is the maximum percentage of non-refundable "Contributions in Aid of Construction" ("CIAC") appropriate as a percent of total capital for a private or investor owned water utility?

The Commission has not established a fixed percentage of plant that ought to be supported by advances or contributions in all cases, but it has approved rate bases that included advances or contributions of approximately 20-25 percent. An over-reliance on advances or contributions can result in a utility that has an inadequate investment of its own in it plant. An under-reliance on advances and contributions (which serve as a credit to rate base) can result in customers paying returns on too large a rate base. The determination of an appropriate percentage of advances and contributions is like the determination of an optimal capital structure—it must be determined on a case-by-case basis.

4. What is the most appropriate and most economical capital structure for a "new" water or wastewater utility?

As indicated above, there is no single "most appropriate" capital structure that can be applied in every instance. An appropriate capital structure will usually consist of a balance of advances and contributions (both cost-free sources of capital) and of debt and equity. A utility should have sufficient equity investment that it has a vested interest in the success of the company, having its own funds at risk and subject to appropriate reward. However, an appropriate level of debt financing should be included, as debt is a lower cost method of financing than is equity.

RESPECTFULLY SUBMITTED this 23rd day of June,

Scott S. Wakefield
Chief Counsel

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