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AZ CORP COMMISSION

ARIZONA CORPORATION COMMISSION

September 5, 2001

Chairman William Mundell
Commissioner Marc Spitzer
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, Arizona 85007

Arizona Corporation Commission
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Re: Water Task Force Report – Docket No. W-00000C-98-0153
Decision No. 62993

Dear Colleagues:

I am in receipt of the Commission Staff's June 29, 2001 Water Task Force (WTF) report on Decision No. 62993, and the direction given by the Commission to develop policy statements for further consideration. I believe that staff has done an excellent job outlining some of the major issues pertinent to water regulation reform. I would like to bring to your attention one particular issue of importance which directly impacts a Commission policy goal of water industry consolidation – the use of acquisition adjustments.

Originally developed to encourage the consolidation of small and/or non-viable water systems into larger, more efficient ones, the acquisition adjustment is seen as a regulatory tool to encourage larger companies to generate greater 'economies of scale' by acquiring smaller, less efficient systems. In its June 29, 2001 report, Staff listed six conditions that a water company must prove by a preponderance of the evidence in order to obtain an acquisition adjustment or rate of return premium. However, I believe that one such condition – that the acquired company be limited to a class D or E utility – will be ineffective in encouraging regional consolidation where no class D or E utilities exist. Alternatively, it will take away an incentive for two class C water systems to merge.

Provided that the other five conditions proposed by staff are adequate enough to protect the public against an abuse of these regulatory incentives (acquisition adjustments and rate of return premiums), the Commission should be expanding opportunities for water systems in Arizona to consolidate, regardless of size. In the next 20 years, private water companies around the nation will face a daunting task; they must comply with increasingly stringent federal regulations (i.e. arsenic levels), mandates of the Safe Drinking Water Act ("SDWA"), and improve or replace a rapidly aging infrastructure. Unlike recent trends in deregulating telecommunications and electricity, the traditional economic principles which gave way to monopolies still apply in the water industry.

While I understand that the Commission has broad discretion to implement policy considerations within the body of its Decisions, it is important that such policies remain flexible in trying to achieve a desired result -- which in this case, is water industry consolidation. For instance, if a class A water company seeks an acquisition adjustment or rate of return premium for acquiring a class C system, it will still have to meet the other conditions recommended by staff; there will be no negative impact to the viability of the acquiring company; acquired system's customers will receive improved service; the purchase price must be fair and reasonable, conducted at arms-length, and the acquisition must be in the public interest. If the Commission establishes a policy limiting acquisition adjustments to only those instances where the acquired company is a class D or E company, medium to larger companies may be less willing to consolidate amongst themselves.

Much will depend on how the Commission ultimately decides to implement the policy goals and regulatory reforms contained in the WTF report. We may seek to give our Utilities Division staff a general policy outline to follow when considering requests for acquisition adjustments and rate of return premiums, instead of formally codifying such policy in our administrative rules. Some policies may need statutory change and the development of a legislative agenda. Nevertheless, I look forward to our discussion on water issues as a whole, and what role the Arizona Corporation Commission can take in helping to address consumers' needs today, and into the future.

Thank you for your time and consideration in this matter.

Sincerely,

Jim Irvin, Commissioner
Arizona Corporation Commission

Cc: Docket Control