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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission
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WATER UTILITY ASSOCIATION OF ARIZONA
916 WEST ADAMS SUITE 3
PHOENIX, AZ 85007

GREG PATTERSON, DIRECTOR

IN THE MATTER OF THE APPLICATIONS OF GLOBAL WATER--PALO VERDE UTILITIES COMPANY; VALENCIA WATER COMPANY--GREATER BUCKEYE DIVISION; WILLOW VALLEY WATER COMPANY; GLOBAL WATER-SANTA CRUZ WATER COMPANY; WATER UTILITY OF GREATER TONOPAH INC.; AND VALENCIA WATER COMPANY—TOWN DIVISION FOR PERMANENT BASE RATE INCREASES FOR WATER SERVICE	DOCKET NOS. SW-20445A-09-0077; W-02451A-09-0078; W-01732A-09-0079; W-20446A-09-0080; W-02450A-09-0081; AND W-01212A-09-0082 **INITIAL POST-HEARING BRIEF**

INITIAL POST-HEARING BRIEF OF THE WATER UTILITIES ASSOCIATION OF ARIZONA

Introduction

The Water Utilities Association of Arizona is a non-profit corporation representing the investor-owned segment of the water industry in the state of Arizona. The association has a regular membership of approximately 500 investor-owned water companies, serving from a few to nearly 300,000 customers.

The purpose of the Association is to promote regulatory policies that will: promote investment, encourage conservation and protect consumers in order to ensure that Arizona has adequate supplies of safe, affordable water—as well as the infrastructure required to deliver that water to consumers at affordable prices.

The WUAA also strives to protect the interests of the investor-owned water companies by keeping members informed about the technical, regulatory and financial changes that affect every aspect of the private water industry.

The WUAA also participates in cases at the Arizona Corporation Commission to the extent that the issues presented affect WUAA members. Global Water is not a member of the WUAA; however, several of the issues presented in the Global case—Acquisition Adjustments, and Contributions in Aid of Construction-- are common to WUAA members. Other issues such as Infrastructure Coordination and Financing Agreements (ICFAs) are unique to Global and will not be discussed in this brief.

Acquisition Adjustments.

The Arizona Corporation Commission has struggled for years with the problems associated with troubled water systems. In 1998, the ACC voted to establish the Water Task force in an effort to address the myriad problems associated with the private water industry and members of the Regulatory Reform Subcommittee reached consensus on five goals—the first of which was: "Reduce the number of small non-viable water systems through new rules and procedures."[1]

The task force was split on the policies necessary to incent the large companies to acquire the smaller ones—ACC Staff for example supported acquisition adjustments in which the rate base of the acquired company was increased to reflect the fair market value at the time of the purchase[2]. RUCO for its part supported a menu of options including a premium on a company's rate of return, surcharge mechanism or deferred accounting order[3].

While parties disagreed on the particular mechanisms need to incentivize large companies to acquire smaller "non-viable" companies, all members of the task force agreed on two things. First that the number of small non-viable water systems should be reduced and second, "All members of the Task Force agreed that negative Acquisition adjustments should never be imposed."[4]

Here, Global Water Parent Company has spent millions of dollars to purchase 25 "troubled" water companies as part of a comprehensive plan that the Company calls "Total Water Management". While most of these companies had purchase prices far in excess of their book value, Global has not requested that the rate bases of the companies be increased to reflect the cost of the Acquisitions.[5]

However the Staff recommendation—subsequently adopted by RUCO[6]—would have the effect of imposing a negative acquisition adjustment on the purchase of these troubled companies. By acquiring non-viable small water companies, Global Parent Company voluntarily engaged in

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[1] Ex A-46 (1999 Water Task Force) W00000C-98-0153 at page 3.
[2] *Id* at Page 8.
[3] Id at 9.
[4] Id at 9.
[5] Tr.(Hill) 56:1 to 57:11
[6] Tr.(Rigsby)at 571:10

the behavior that the Commission's Water Task force encouraged—and did so without seeking the types of incentives that Staff and RUCO agreed would be necessary. Yet, instead of congratulating Global for helping to fulfill the Commission's goals, Staff and RUCO are advocating that the Commission impose a negative acquisition Adjustment--the very penalty that ALL parties agreed should NEVER be imposed.

By deeming the ICFAs as Contributions in Aid of Construction (CAIC) and then "imputing" that CIAC to the acquired companies, Staff—with RUCO in tow--have conjured a mechanism that manages to leave the acquired companies with a negative rate base. Moreover, the rate base not only receives a negative adjustment, but also, it is reduced by the full extent of the purchase price. Staff has crafted a 100%, dollar-for-dollar, negative acquisition adjustment.

Staff and RUCO's two part mechanism of reclassifying ICFA's as CAIC and then imputing that CAIC to the Acquisition of small non-viable water system thus leaving those systems saddled with negative rate base should be rejected.

Contributions in Aid of Construction

As previously stated, the WUAA takes no position on whether Infrastructure Coordination and Financing Agreements (ICFAs) should or should not be classified as Contributions in Aid of Construction.

However, if the Commission chooses to classify the ICFAs as CAIC, then CAIC should only "removed" from rate base if it was used to finance a purchase that was actually placed into rate base. (This was the original RUCO position)[7].

The purpose of removing CAIC from rate base is to eliminate the windfall that would inure to a company that was allowed to earn a return on an item of rate base for which the company did not actually pay[8]. If a developer provides CAIC to build, say, a well, then the well

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[7] A RUCO-4 (Rigsby Direct)page 13.
[8] Tr.(Jaress) 732:15-18

would have to be subtracted out of rate base in order to prevent the company from earning a return on a component of rate base that the company itself did not purchase.[9]

However, if the well is removed from rate base for another reason (e.g. because it is not used and useful) and the Commission also subtracts out the CAIC, then the second entry acts as a double count--instead of avoiding a windfall, the company incurs a penalty.[10]

Here, the ICFAs were used to purchase troubled companies whose Fair Market Value was higher than their book value. In order to place these acquired companies into rate base, the Commission would have to grant an Acquisition Adjustment for the difference between the Rate Base of the acquired company and its purchase price. The ACC has traditionally rejected such acquisition adjustments and Global chose not to even seek an acquisition adjustment.[11]

Therefore, since the items purchased by CAIC (premiums on troubled companies) were not placed into rate base then it would be an accounting error to simply assign, or somehow impute CAIC to rate base and subtract it.

Such an adjustment makes no sense from an accounting perspective and also serves as a Negative Acquisition Adjustment—which was specifically rejected by ALL parties (including Staff and RUCO) in the 1999 Water Task Force Report. Ther efore, the proper Accounting Treatment for the CAIC requires a two-part analysis.

The Two Step Analysis: In order to Subtract out CAIC, the Commission must determine that the ICFAs are CAIC and also determine that the ICFAs were spent on Plant.

The most complex issue in this case is the two step analysis needed to determine if the IFCAs should be properly subtracted from rate base. Indeed, there is substantial confusion

[9] Id. 732:14
[10] TR Rigsby 56:1-10
[11] Tr. (Hill)56:23

among the parties as to whether the analysis actually requires two steps.[12] WUAA believes that, RUCO Witness Rigsby in his Direct Testimony, provided the clearest articulation of the required analysis.

Based on RUCO's review of the ICFA's obtained through discovery, ICFA funds that are intended to provide utility plant that is used to serve new development should be treated as CIAC[13].

The first step in the analysis is to determine that ICFAs are CAIC. By this point in his testimony, Mr. Rigsby has concluded that this is indeed true. (WUAA has no position on this conclusion.)

The second step is well articulated by Mr. Rigsby when he adds that ICFAs that have been reclassified as CAIC are only to be treated as CAIC when they are "intended to provide utility plant that is used to serve new development." In other words to the extend that the ICFAs are in rate base. Mr. Rigsby's analysis is consistent with the testimony of both Staff and RUCO that the purpose of a CAIC adjustment is to prevent a windfall to the company.[14]

Unfortunately, Mr. Rigsby abandoned that position in his surrebuttal testimony. In justifying the switch, Mr. Rigsby concentrates on the first part of the analysis—ICFAs are CAIC--as well as the policy reasons surrounding CAIC adjustments. He fails to articulate why he dropped his second prong that the investment must have been "intended to provide plant that is used to serve new development".

Indeed, although Mr. Rigsby adopted staff's methodology, there is some question—even among staff--as to what that methodology entails. On cross examination, staff witness Linda

[12] See for example Tr. (Rigsby) 572:1-18
[13] Rigsby Direct at page 13 lines 18-21.
[14] TR (Rigsby) 571:4-10 and Tr. (Jaress) 732:15-18

Jaress agreed that the Commission would have to perform a two step process—Step 1, determine that ICFA's are CAIC, and Step 2, the ICFAs were used to purchase plant[15]. However, Ms. Jaress switched that answer without explanation on Redirect[16]. And when asked to solve a hypothetical example on re-cross, proceeded to perform a two part analysis in which she ultimately presented two conflicting answers.[17]

WUAA believes that the original RUCO position is the correct one--if ICFAs are treated as CAIC, they should only be subtracted out to the extent that they were "intended to provide utility plant that is used to serve new development." RUCO's original two-step analysis is consistent with the theory that CAIC adjustments are made to prevent a windfall to the company and consistent with the analysis of all parties in the 1999 Water Task force that negative acquisition adjustments should never be allowed.

Money may be fungible, but it is not interchangeable.

If the Commission determines that ICFAs are CAIC and goes on to evaluate whether the ICFAs were used to purchase plant then the heart of the analysis will be a question about whether OTHER money was spent on the plant in question. Clearly the same amount of plant can not be simultaneously purchased from multiple sources.

The Company argues that much of the plant in question was purchased with IDA bonds. Staff argues that money is fungible and the IDA bonds freed up money for other purposes. The company argues that those other purposes where the acquisition of troubled water companies---not the building of plant.

The issue is not merely one of semantics. If the ICFAs are classified as CAIC and if the CAIC was spent on plant, then the traditional CAIC adjustment would require the removal of the

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15 Tr. (Jaress) 746:11-14

16 Tr. (Jaress) 883:21 to 884:13

17 Tr. (Jaress) 898:20 to 900:7

plant from rate base. However, if the IFCAs are CAIC and the CAIC was spent on the acquisition of troubled water companies, and the company did not seek an acquisition adjustment, then the CAIC subtraction would be inappropriate.

So is the fact that the company purchased the plant with IDA bonds overwhelmed by the argument that money is fungible? After all, even Mr. Hill concedes that money is fungible. The key is that money, while fungible is not interchangeable. Money that comes from a specific source and is earmarked for a specific purpose must be spent on that purpose. To the extent that IDA bonds were used to finance a portion of plant, then that same portion of plant was not also financed by another source.

Tax Treatment of CAIC

If the Commission determines that ICFAs are CAIC and if the Commission determines that the ICFAs were spent on items that were placed in rate base, then—in order to prevent a windfall to the company--the Commission should perform an adjustment to remove the items financed by CAIC from rate base[18]. That would be classic treatment of CAIC.

If that definition is accepted, While the calculation of that adjustment may prove to be complex, one thing is clear—taxes paid to the IRS on ICFAs did not go into rate base and are not a component of the items to be removed from rate base. The parties agree that the amount raised by ICFAs was about $60 million and the amount paid to the IRS was about $20 million and the amount spent on "stuff" was about $40 million[19]. While the Commission may decide that the ICFAs are CAIC and that the $40 million was spent on plant that went into rate base, the maximum amount of the CAIC adjustment is the approximately $40 million that was raised net of tax. Witness Jaress confirmed this analysis[20] and described it as the old "gross-up method." [21]

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[18] See for example Tr. (Rigsby) 559: 6-10
[19] Tr. (Jaress) 734:5-12
[20] Tr. (Jaress) 736:22 to 737:5
[21] Tr. (Jaress) 733:5

CAIC transactions used to be taxable and Ms. Jaress referred to the method by which taxes were taken into account so the CAIC adjustment could be net of taxes. Parties agree that ICFAs are unique[22]. Parties also agree that ICFAs are taxable[23]. Staff and RUCO argue that ICFAs are CIAC. If Staff and RUCO win the debate then the Commission will determine that ICFAs are taxable CAIC. In that case, then the Commission should treat the ICFAs the same way that taxable CAIC was treated in the past—ie. Net of taxes.

Respectfully submitted this 5th day of February 2010

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[22] Tr. (Rowell) 348:20
[23] Tr. (Jaress) 734:5-12

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