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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF GLOBAL WATER – PALO VERDE UTILITIES COMPANY FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERY THROUGHOUT THE STATE OF ARIZONA.	Docket No. SW-20445A-09-0077
IN THE MATTER OF THE APPLICATION OF VALENCIA WATER COMPANY – GREATER BUCKEYE DIVISION FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERY THROUGHOUT THE STATE OF ARIZONA.	Docket No. W-02451A-09-0078
IN THE MATTER OF THE APPLICATION OF WILLOW VALLEY WATER COMPANY FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERY THROUGHOUT THE STATE OF ARIZONA.	Docket No. W-01732A-09-0079
IN THE MATTER OF THE APPLICATION OF GLOBAL WATER – SANTA CRUZ WATER COMPANY FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERY THROUGHOUT THE STATE OF ARIZONA.	Docket No. W-20446A-09-0080

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IN THE MATTER OF THE APPLICATION OF WATER UTILITY OF GREATER TONOPAH FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERY THROUGHOUT THE STATE OF ARIZONA.	Docket No. W-02450A-09-0081
IN THE MATTER OF THE APPLICATION OF VALENCIA WATER COMPANY – TOWN DIVISION FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERY THROUGHOUT THE STATE OF ARIZONA.	Docket No. W-01212A-09-0082

RESIDENTIAL UTILITY CONSUMER OFFICE'S REPLY BRIEF

The Residential Utility Consumer Office ("RUCO") replies to Global Water's ("Global Water," "Global," "Global Utilities," or "Company") and the Arizona Corporation Commission Staff's ("Staff") post hearing briefs as follows.

INTRODUCTION

Global continues to tout the efforts it has made towards its vision of Total Water Management ("TWM") and the efforts it has made to achieve TWM while at the same time mitigate the impact of rate increases. Company Brief at 1-14. The Company bullet points numerous measures it has taken to mitigate its proposed rate increase. Id. at 1-2. RUCO is encouraged by the efforts this Company has made. They clearly demonstrate a good corporate character and a concern for arguably Arizona's most precious resource.

Nonetheless, Global's efforts should not provide the Company with an entitlement to lower rates than what the Commission would otherwise consider. Nor should Global's efforts persuade the Commission to approve unusual regulatory accounting measures which result in higher rates to the ratepayer. CIAC is not the enemy – most Arizona Water utilities have financed some portion of their ratebase with CIAC and as RUCO pointed out in its Closing Brief, a balanced amount of CIAC in a utility is a benefit to both ratepayers and shareholders. RUCO Brief at 5.

The Company is correct that the Commission should be concerned with water scarcity. Company Brief at 4. But neither RUCO nor Staff has eliminated the "only tool" that can resolve the issue of water scarcity. Company Brief at 4. Water scarcity is a region-wide concern, particularly in the desert. There is no quick solution and surely an accounting gimmick which has the effect of unnecessarily raising the rates of ratepayers is not the answer to such a systemic problem. Perhaps the higher rates, depending on the rate design might have the effect of encouraging conservation but that is not the type of solution to water scarcity that the Company is referencing. The solution, if there even is one, will require the coming together of many stakeholders, including but not limited the water industry, the Commission, RUCO and other private interest groups. The Commission should not be persuaded that ICFA's are the solution to Arizona's water scarcity problem. Such a short-sighted view goes against the interests of Arizona's ratepayers.

The first part of Global's Closing Brief appears to be a discourse on water scarcity and the great lengths and concessions the Company made to limit the issues in this case – perhaps to bring the focus back to the one issue that the Company seems overly-passionate about - water scarcity and the benefit of ICFAs. RUCO will not engage in a debate on these points since RUCO does not argue that water scarcity is a concern and the Company has acted in good faith in limiting the issues. This is a rate case, not a forum on water scarcity and the focus should be on the Company's proposed accounting adjustment (or lack of adjustment).

THE COMPANY'S RECOMMENDATION TO NOT TREAT THE ICFA PROCEEDS AS CIAC SHOULD BE REJECTED

When the smoke clears, the issue is straight forward – how should the Commission account for the ICFA proceeds? As explained above, simply ignoring them is not the answer to solving the states water scarcity issues. In fact, simply ignoring the proceeds and eliminating most if not all of CIAC from the Company's books would be harmful to the ratepayers. See RUCO's Brief at 5-7.

Stepping back, it still remains unclear how exactly the Company perceives the ICFA's. The Company argues that the ICFA proceeds were used to fund its acquisitions. Company Brief at 12. However, the Company in its direct case claimed that the ICFA fees were revenue to its parent and were partially to offset its parents carrying costs. A-12 at 15. Until its rejoinder, the Company offered no evidence to indicate where the proceeds from the ICFA's went.

In rejoinder, the Company presented an excerpt from an audited financial statement for 2008 and some bank statements to supports its contention that the ICFA proceeds were used to pay solely for Global Parent's acquisitions. A-9, Exhibit 1 and 2. But even the most expansive reading of the exhibits fails to disclose what the ICFA proceeds were actually used for. The Company is attempting to keep over $24,000,000 in Global's ratebase that should otherwise not be there through an accounting sleight of hand. The burden is on the Company to not only show but prove what the ICFA proceeds were used for. A couple non-specific banking statements and a portion of a audited financial statement which if given any weight, would only account for a small portion of the ICFA proceeds in this case, is hardly substantial evidence of what the ICFA proceeds were used for.

In response, the Company contends that there is no plausible explanation of how Global Parent could have made the acquisitions without using the ICFA proceeds. Company Brief at 13. Again, it is not the Commission's burden to audit Global's parent and ascertain what it did with the ICFA proceeds. The Company has offered flimsy and conflicting evidence to support its contention and the argument that there is no other plausible explanation to explain how the Company's parent spent its money is also flimsy.

Next the Company argues that deducting ICFA fees from Global's ratebase will discourage acquisitions. Company Brief at 14. This argument is misplaced. Encouraging acquisitions through setting rates that are unfair to ratepayers is not good public policy or good ratemaking.

Even if the Company could prove that the ICFA proceeds were used for acquisitions and associated carrying costs it is a distinction that makes little difference from RUCO's perspective. There is no dispute that developers are the providers of the ICFA proceeds and whether the proceeds were used to acquire utility plant or to fund utility acquisitions is a distinction that is of little significance. In the case where developer contributions are used to fund acquisitions, the developer's contributions free up money that would otherwise be used to fund Global's plant. Money is fungible, and allowing this type of accounting will place the Commission on a slippery slope.

Obviously accounting methods which are designed to circumvent traditional regulatory accounting and boost the Company's revenues are not in the public interest. What makes the Company's recommendation so suspect is the nature of the ICFA proceeds. Developer contributions are cost free capital to the Company's parent. S-10 at 10. If the parent is investing the proceeds in the form of equity into the utility, and the Company is successful in its proposal to not treat the contributions as CIAC, Global Parent will be earning a return on cost free, non-investor supplied capital. Id. This situation contrasts with the situation where the developer makes the contributions to the utility and the contributions are treated as CIAC. In the latter situation the risk is on the developer and not the ratepayer and shareholder. Whereas, in the former situation the risk is shifted to the ratepayer. Clearly, in the absence of the Global Parent/Global Utility relationship, ICFA contracts would not be executed by developers - developer contributions would be made directly to the utility. Transcript at 723.

The Company argues that Staff and RUCO's belief that the ICFA proceeds were used for utility plant and not acquisitions is mere conjecture to be given little or no weight. Company Brief at 16. However, from the developer's perspective there would be no other reason to make the contributions. Transcript at 723. The developer's purpose is to acquire utility services. Id. It is a business decision to acquire a service – nothing more. The developer is not interested in Global Water management – its objective, as the Company even acknowledges, is to build and sell houses. A-8 at 17. The developer is not interested in investing in its own water company – how else can one explain a zero or negative ratebase? In short, the developer has only one interest – its own and its ability to obtain service – that is the purpose for the ICFA payments. Id. Neither Staff nor RUCO may be able to directly link the proceeds to the utility plant but the Company can do no better in linking it to acquisitions. The developer, however, makes the contributions in exchange for current or future service from the utility, and not the parent, and that is why the utility's ratebase should be reduced accordingly.

The Company further complains that traditional approaches to Total Water Management like CIAC do not work. Company Brief at 19. There is no evidence in the record of this. Other regulated utilities in this state that use CIAC in a balanced approach are successful. Transcript at 576. It is true that utilities that over-rely on CIAC, just as utilities' that over-rely on other forms of financing such as debt and equity are at a disadvantage. Company Brief at 24. It is not surprising that these utilities become and often-times remain financially troubled. However, as the Company explains, such a business plan is attractive to a developer who wants to invest little or nothing in its utility and run up its expenses. A-8 at 23. This allows the developer to invest little and get paid a return. Id. These developer owned utilities are "incented to have high operating expenses they have lots of labor, and nearly always the owners and managers hire relatives and friends." Id.

The problem, as the Company describes it, is with the developer's incentives, not traditional ratemaking. Making exceptions to traditional ratemaking is a possible solution, but it does not address the problem. If the Commission is serious about dealing with this issue, as RUCO's witness, William Rigsby testified a good place to start would be in a generic docket created to address the problem and then consider solutions. Transcript at 643.

Finally, the Company argues that the Generic Docket Staff Report does not control the treatment of ICFA fees. Company Brief at 28. In support of its argument, the Company, in detail, goes through a tortured recital of RUCO's direct and surrebuttal positions in this case and RUCO's position in the Generic docket (Docket # W-00000C-06-0149). Id. at 28-30. This is an unusual way to make a point – a point that RUCO does not even take issue – that the Generic docket does not control the outcome in this case. Just so the record is correct, Staff's direct position, as Mr. Rigsby testified to, was one factor that RUCO considered when changing its position. Transcript at 675. As far as the generic docket was concerned, Mr. Rigsby made clear that he was not involved in that docket nor was he familiar with it. Id. His point was that the Company could have mitigated the situation had the Company followed

Staff's recommendation in that report. RUCO-7 at 11. Besides, if the Company's whole point here is that the Generic Docket Staff Report does not control in this case, what difference does RUCO's position in that docket make? RUCO is at a loss to understand the Company's argument here.

In sum, the Commission should treat the ICFA proceeds as CIAC and deduct:

PVWC	($10,167,233)
SCWC	($6,105,227)
VWC – Town Div.	$0
VWC – GB Div.	$0
WUGT	($8,721,514)
WVWC	$0

R-2 at 6, RLM-3.[1]

FRANCHISE FEE PASS-THROUGH AND PUBLIC PRIVATE PARTNERSHIP AGREEMENT

RUCO incorporates its position set forth in its Closing Brief (RUCO Brief).[2] RUCO Brief at 8-9. RUCO's concern here is the potential for the Company to over-recover if it is allowed a pass through. R-4 at 16-17. Allowing the Company to recover through an increase in operating expenses eliminates any incentives and guarantees that the Company will only recover the collection of the franchise fees.

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[1] These are the net adjustments after amortization.

[2] Where RUCO's Closing Brief replies to the arguments raised in the Company's Closing Brief and RUCO has nothing more to add or where the Company has not addressed an issue in its Closing Brief, RUCO will simply incorporate the argument that it made in its Closing Brief as its reply.

DISTRIBUTED RENEWABLE ENERGY RECOVERY AND CONSERVATION

The Company seeks to recover its distributed renewable energy recovery tariff through an adjustor mechanism. R-4 at 5. In its Closing Brief, the Company argues the attributes of the "DREAM" tariff but provides no legal argument for the adjustor mechanism other than to say that it is like the ACRM. Company Brief at 51. The tariff is commendable, the proposed method of collection, however, is illegal for all of the reasons RUCO set forth in its Closing Brief. RUCO Brief at 9-13. Adjustor mechanisms are an exception to this state's constitutionally mandated fair value requirement and should only be considered under the most extraordinary circumstances. Those circumstances do not exist here and the Commission should not stretch the exception to include the types of cost under consideration.

PROPERTY TAX EXPENSE AND ADJUSTOR

RUCO and the Company used the same methodology to compute property tax expense. R-2 at 6. The difference in the recommendations is that each party's recommendation is based on its proposed level of annual revenue. Id. The Company is correct that RUCO opposes the property tax adjustor as a method to recover its property tax expense. Company Brief at 60. RUCO opposes the adjustor for all the reasons set forth in RUCO's Closing Brief in this case regarding the Distributed Renewable Energy Recovery and Conservation. RUCO Brief at 9- 13. An adjustor mechanism is not an appropriate or legal method of recovery for such a routine expense.

INCOME ANNUALIZATION TO RECOGNIZE POST TEST YEAR CUSTOMER LEVELS

RUCO incorporates its position set forth in its Closing Brief at 14, which corresponds with Staff and the Companies' positions. Company Brief at 65.

BAD DEBT EXPENSE

RUCO and the Company agree that the unadjusted test year bad debt expense (actual bad debt expense) as a fair and reasonable reflection of the historical annual amount. RUCO Brief at 14-15, Company Brief at 59.

DEPRECIATION EXPENSE

RUCO incorporates its position set forth in its Closing Brief at 15. This adjustment is specific to PVUC, SCWC AND WUGT and is a companion adjustment to adjustment made to reclassify ICFA discussed above and reflects the amortization of the CIAC and its reduction to the depreciation expense. R-2 at 5-6.

INCOME TAXES

RUCO's adjustment reflects income tax expenses calculated on RUCO's recommended revenues and expenses. The Companies recommendation also corresponds with its revenue requirement. Company Brief at 65.

CONTRACTUAL SERVICES – MANAGEMENT FEES

RUCO and the Company are now in substantial agreement with contractual services – management fees. The Company agrees to remove payroll bonus as identified on page 6 of the rebuttal testimony of Company witness Jamie Moe. R-2 at 8.

CENTRAL ARIZONA GROUNDWATER REPLENISHMENT DISTRICT FEES ('CAGRD')

In reply to the Company's argument RUCO incorporates its position set forth in its Closing Brief at 17-18. In reply, however, to the Company's assertion that RUCO is amenable to an adjustor mechanism proposal similar to the one Staff proposed in the Johnson case, the Company is wrong. The Company references the Joint Matrix to support its assertion. The

Joint Matrix notes that RUCO will accept the Commission's decision in Johnson Utilities which is consistent with RUCO's testimony. See Joint Matrix, Transcript at 542. In Johnson, Staff proposed an adjustor that RUCO objected to in principle for all the reasons set forth in RUCO's Closing Brief in this case regarding the Distributed Renewable Energy Recovery and Conservation. RUCO Brief at 9- 13. In short, an adjustor mechanism is not an appropriate or legal method of recovery for such a routine, non volatile fee as the CAGRD assessment. RUCO also opposes a pass-through as the Company recommends for the reasons set forth in RUCO's Closing Brief at 17-18. RUCO does not oppose the recovery of the assessment, however, as an expense only after the Company is actually assessed the fee. While RUCO intends to accept[3] the Commission's decision in Johnson, its application only becomes relevant here when the fee is actually assessed.

LOW INCOME TARRIFF, WAGE AND EXPENSE RECLASSIFICATION AND DSM.

RUCO does not oppose the Company's proposals.

COST OF CAPITAL

With regard to capital structure and cost of debt RUCO incorporates its arguments raised in its Closing Brief at 18-20. It is difficult to reply to Staff's and the Company's Cost of Equity analysis since **neither Staff nor the Company performed an analysis**. There are, however, a couple points raised in Staff and the Company's Brief that require a reply.

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[3] If the ruling goes against RUCO, at this time RUCO does not intend to appeal. However, RUCO has not made a final decision and will not make a final decision until the Decision is made. The same holds true for any issue that is the subject of this proceeding or any proceeding which RUCO is a party.

The Company notes that the Commission has rejected RUCO's cost of equity recommendations on numerous occasions. True, but that was in cases where Staff and the subject companies performed a cost of equity analysis. Therefore there was evidence in those records to support the Commission's decision. There is no such evidence in this case. And besides, the cost of equity analysis is unique to each company and depends on many factors unique to the Company, so the fact that the Commission rejected RUCO's recommendation in other cases should not be considered guiding in this case.

Staff claims that RUCO's cost of equity analysis, like Staffs and the Companies is based on RUCO's cost of equity analysis in other cases. Staff Brief at 11. Staff relies on the testimony of Bill Rigsby at the hearing. Id. In the hearing, Mr. Rigsby testified that he considered his cost of equity in other cases when deciding to make an adjustment to his cost of equity results in this case. Transcript at 588. Staff's assertion that RUCO's analysis in this case is similar to the analysis – or lack of analysis that Staff and the Company did in this case is not only misleading but it is wrong. The Commission should approve RUCO's recommended cost of equity.

RATE DESIGN

RUCO incorporates its rate design argument raised in its Closing Brief at 25-28. In short, RUCO's proposed rate design is consistent with the Company's proposed rate design, but reflects RUCO's recommended revenue requirement. R-8 at 3. RUCO's recommended rate design is based on cost of service and RUCO did not prepare a consolidation proposal because RUCO is not convinced that the Company's consolidation proposal is in the best interests of the ratepayers whose rates would be based on cost of service – Palo Verde, Willow Valley and Santa Cruz ratepayers. R-5 at 3.

RUCO is also recommending that the Commission adopt the Company-proposed three-year phase-in of rates for Palo Verde Utilities Company that will generate RUCO's recommended level of operating revenue. The Company is also requesting phased in rates for the Palo Verde Utilities Company wastewater operating system.

RUCO agrees with the Company-proposed six tier rate structure and has increased the minimum monthly charge for each of the five water providers included in the Company's filing. RUCO-5 at 8, Company Brief at 40-41. RUCO, however, does not support the Company's proposal regarding the volumetric rebate or the decoupling proposal. The six-tier rate structure and the increased monthly minimum will send a proper price signal to conserve water, but the volumetric rebate will not encourage conservation. Id. The Company sees the rebate as a step forward from a conservation perspective but in fact the rebate is flawed because rebates are awarded to all customers who consume less than the median amount, <u>regardless</u> of whether those customers have always been below the median point prior to the implementation of the rebate program. Furthermore, rebates would not be given to those high use customers who demonstrably reduce their consumption, yet still fall above the median amount. Id. RUCO sees the rebate program as a step back in terms of conservation and not a "significant step forward".

CONCLUSION

RUCO recommends that the Commission treat the ICFA proceeds as CIAC.

RUCO further recommends the Commission should adopt RUCO's recommended capital structure for Palo Verde and Santa Cruz districts of 62.11 percent equity and 37.89% debt and an operating margin of 8.03 percent for WUGT. Id. at 51, R-7 at 18. Further, the

Commission should adopt RUCO's recommended composite cost of common equity of 9.00%. R-7 at 21.

Finally, in addition to all of the other recommendations listed in this Brief, RUCO recommends that the Commission adopt RUCO's rate design, impose a three-year phase in of rates for Palo Verde Utilities Company, and reject the Company's volumetric rebate proposal and decoupling proposal.

RESPECTFULLY SUBMITTED this 19th day of February, 2010.

Daniel W. Pozefsky
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