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April 16, 2010

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Docket Control
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Re: Arizona-American Water Company
Docket Nos. W-01303A-09-0343 and SW-01303A-09-0343

Ladies and Gentlemen:

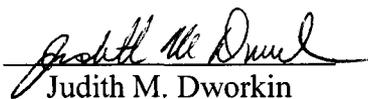
Anthem Community Council, Inc. hereby submits for filing an original and fifteen (15) copies of Its Pre-Hearing Memorandum on Disputed Refund Payment Issue. Copies of this Pre-Hearing Memorandum will also be electronically served or mailed to all known parties of record in the aforesaid proceedings. Please return two conformed copies with our runner. If you need anything further, please contact me.

Sincerely,

Judith M. Dworkin
Sacks Tierney P.A.

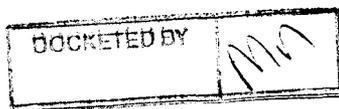
and

Lawrence V. Robertson, Jr.
Attorneys for Anthem Community Council

By: 
Judith M. Dworkin

Arizona Corporation Commission
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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

- KRISTIN K. MAYES, Chairman
- GARY PIERCE
- PAUL NEWMAN
- SANDRA D. KENNEDY
- BOB STUMP

IN THE MATTER OF THE APPLICATION OF)
 ARIZONA-AMERICAN WATER COMPANY,)
 AN ARIZONA CORPORATION, FOR A)
 DETERMINATION OF THE CURRENT FAIR)
 VALUE OF ITS UTILITY PLANT AND)
 PROPERTY AND FOR INCREASES IN ITS)
 RATES AND CHARGES BASED THEREON FOR)
 UTILITY SERVICE BY ITS ANTHEM WATER)
 DISTRICT AND ITS SUN CITY WATER)
 DISTRICT.)

DOCKET NO. W-01303A-09-0343

IN THE MATTER OF THE APPLICATION OF)
 ARIZONA-AMERICAN WATER COMPANY,)
 AN ARIZONA CORPORATION, FOR A)
 DETERMINATION OF THE CURRENT FAIR)
 VALUE OF ITS UTILITY PLANT AND)
 PROPERTY AND FOR INCREASES IN ITS)
 RATES AND CHARGES BASED THEREON FOR)
 UTILITY SERVICE BY ITS ANTHEM/AGUA)
 FRIA WASTEWATER DISTRICT, ITS SUN CITY)
 WASTEWATER DISTRICT AND ITS SUN CITY)
 WEST WASTEWATER DISTRICT.)

DOCKET NO. SW-01303A-09-0343

**INTERVENER ANTHEM
COMMUNITY COUNCIL'S PRE-
HEARING MEMORANDUM ON
DISPUTED REFUND PAYMENT
ISSUE**

SACKS TIERNEY P.A., ATTORNEYS
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 SCOTTSDALE, ARIZONA 85251-3693

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I.

INTRODUCTION

The Anthem Community Council (“Anthem”) intends to argue in the forthcoming hearings in the above-captioned and above-docketed proceedings (“instant proceedings”) that the Commission should (i) permanently exclude from Arizona-American Water Company’s (“AAWC”) rate base, and (ii) deny any associated ratemaking recognition of the 2007 \$3.1 and March 31, 2008 \$20.2 million refund payments (collectively “disputed refund payments”) made by AAWC to Pulte Corporation (“Pulte”).¹ The refund payments in question were occasioned by a September 28, 1997 Agreement For The Villages At Desert Hills Water/Wastewater Infrastructure (“Infrastructure Agreement”) among predecessors-in-interest to AAWC and Pulte; and, it is the position of Anthem that neither the Infrastructure Agreement nor any of the subsequent First through Fourth Amendments thereto have been approved by the Commission nor recognized for ratemaking purposes.

In that regard, and as most recently noted by the Commission in its Decision No. 70372 (June 13, 2008) in AAWC’s 2005 rate case,

“At this time, no party has alleged, and we do not find, that the Company’s repayment of developer advances under the Anthem Agreements has been imprudent or improper.” [Decision No. 70372 at page 43, lines 11-13] [emphasis added]

* * *

“[However] Our determination in this case is not intended to have any bearing on our determination in any subsequent case filed by the Company for these districts regarding the Company’s agreement to refund to Pulte almost all of the costs required to construct Anthem’s water [and wastewater] infrastructure.” [Decision No. 70372 at page 43, lines 20-23] [emphasis added]

The “time” to question the “reasonableness” of such undertaking by AAWC (and its predecessors-in-interest), as well as the regulatory status of the document(s) occasioning

¹ Anthem will also be addressing other issues in the instant proceeding through (i) the testimony and exhibits of its own witness(es), (ii) cross-examination of other parties’ witnesses, and (iii) oral argument and/or briefs, as appropriate.

1 such undertaking, has now arrived in the context of the instant proceedings, which are
2 AAWC's "subsequent case" for AAWC's Anthem Water District and Anthem/Agua Fria
3 Wastewater District. In the following Sections of this Pre-Hearing Memorandum, Anthem
4 will discuss the reasons why it believes that the Commission should (i) permanently
5 exclude from AAWC's rate base, and (ii) deny any associated ratemaking recognition of
6 the aforesaid disputed refund payments made to Pulte by AAWC.²

7 **II.**

8 **THE INFRASTRUCTURE AGREEMENT AND AMENDMENTS**
9 **THERE TO HAVE NEVER BEEN APPROVED BY THE COMMISSION³**

10 **A. Decision No. 60975 (June 19, 1998).**

11 On October 29, 1997 Citizens Utilities Company, Citizens Water Services Company
12 of Arizona and Citizens Water Resources Company of Arizona (collectively "Citizens")
13 filed a Joint Application requesting a CC&N to provide potable water and wastewater
14 public utility service to a planned community development to be known as the Villages at
15 Desert Hills.⁴ Also included within the Joint Application was a request for Commission
16 approval of the Infrastructure Agreement. In that regard, Citizens made the following
17 representation:

18 "Joint Applicants submit that the [Infrastructure] Agreement is
19 reasonable and in the public interest and should, therefore, be
20 approved by the Commission." [Joint Application at page 6,
lines 13-14]

21 Elsewhere in the Joint Application, Citizens stated that

22 _____
23 ² By inference, such exclusion and denial should also be applicable to the \$6.7 million refund AAWC was scheduled
24 to make to Pulte during March 2010. However, that amount is not included within the rate base claimed by AAWC
which is a subject of the instant proceedings.

25 ³ As will be discussed in Subsection II (C) of this Pre-Hearing Memorandum, in Decision No. 63445 (March 13, 2001)
26 the Commission did authorize the enlargement of Citizens' CC&Ns to include a 195-acre parcel known as the "Jacka
Parcel." Such inclusion was provided for in the May 8, 2000 First Amendment to the Infrastructure Agreement.
However, as the Commission expressly stated in its subsequent Decision No. 64897 (June 4, 2002)

27 ". . . there was no intent in Decision No. 63445 to approve the substance of the
original Infrastructure Agreement." [Decision No. 64897 at page 6, lines 1-2]

28 ⁴ The name of that development was subsequently changed to Anthem.
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“Commission approval of the [Infrastructure] Agreement and the Purchase Agreement without amendment or modification is a condition subsequent to the continued effectiveness of those agreements, as provided in Section 14.6 (a) of the [Infrastructure] Agreement and Section 17.3 of the Purchase Agreement.” [Joint Application at page 12, lines 14-17] [emphasis added]

Despite the foregoing representation and admonition by Citizens, in its April 16, 1998 Staff Report, the Commission’s Utilities Division recommended that the Commission not act upon Citizens’ request for approval of the Infrastructure Agreement:

“Staff does not recommend that the Commission consider approval of the Infrastructure Agreement between Citizens and a non-regulated entity such as Del Webb under the circumstances described in the application. The approval of the Agreement is not necessary for the Commission’s consideration and decision in these matters. Also, the Commission may propose certain terms and conditions in its order in this case that may not be reflected in the [Infrastructure] Agreement. By declining to approve the [Infrastructure] Agreement the Commission is free to impose these conditions without specifically amending or modifying the [Infrastructure] Agreement.” [Staff Report at page 2, lines 12-18] [emphasis added]⁵

* * *

“Staff further recommends that the Commission not consider any determination regarding the requested approval of the Infrastructure Agreement.” [Staff Report at page 10, lines 11-12]

In its Decision No. 60975 on the Joint Application, the Commission noted that

“At the hearing, Staff recommended that . . . the Commission not consider any determination regarding the requested approval of the Infrastructure Agreement.” [Decision No. 60975, Finding of Fact No. 13(j) at page 6, lines 9 and 27.5-28, respectively]

Thereafter, in Conclusion of Law No. 7, the Commission concluded that

“Staff’s recommendations, as set forth in Finding of Fact No. 13 [inclusive of subparagraph (j)] should be adopted. [Decision No. 60975 at page 10, line 24.5]; and,

⁵ The importance of the underscored language in this quotation will become evident in connection with the discussion of Decision No. 64897 in Section II (D) below.

1 Accordingly, in the Eighth Ordering Paragraph of its decision, the Commission provided
2 that

3 “IT IS FURTHER ORDERED that the Staff recommendations
4 contained in Finding of Fact No. 13 . . . (j), as agreed to by
Citizens Utilities Company, are adopted . . .” [Decision No.
60975 at page 15, lines 4-6]

5 Thus, the first time the Commission was asked to approve the Infrastructure
6 Agreement, it expressly declined to do so.

7 **B. November 24, 1998 Letter Agreement.**

8 On November 24, 1998, Citizens, Del Webb Corporation (“Del Webb”) and Anthem
9 Arizona, L.L.C. (an affiliate of Del Webb) entered into a Letter Agreement “to resolve the
10 consequences of two circumstances,” each of which pertained to the provisions of the
11 Infrastructure Agreement.⁶ The first such “circumstance” was occasioned by the fact that

12 “The [Infrastructure] Agreement was not approved by the
13 Arizona Corporation Commission on or before August 15,
1998.” [Letter Agreement at page 1, lines 19-20]

14 As the Joint Applicants had stated in the October 29, 1997 Joint Application discussed in
15 Section II (A) above, Commission approval of the Infrastructure Agreement without
16 amendment or modification was a condition subsequent to the continued effectiveness of
17 the Infrastructure Agreement. Given that the Commission declined in Decision No. 60975
18 to address or act upon the Infrastructure Agreement at all, it would appear that the
19 subsequent Letter Agreement was entered into with an express purpose of avoiding a
20 termination of the Infrastructure Agreement by reason of the aforesaid “condition
21 subsequent.”

22 In that regard, as may be noted therefrom, the Letter Agreement establishes a
23 formula and schedule by means of which certain refund payments were to be made by
24 Citizens to Del Webb for the period July 1, 2004 through July 1, 2016. In addition, the
25 Letter Agreement also provided that

26 _____
27 ⁶ A copy of the November 24, 1998 Letter Agreement is attached hereto as Appendix “A” and is incorporated herein
28 by this reference.

1 “Within 45 days after executing the First Amendment [of the
2 Infrastructure Agreement], Citizens will re-file for approval by
3 the Arizona Corporation Commission of the [Infrastructure]
4 Agreement, as amended by the First Amendment.” [Letter
5 Agreement at page 2, lines 18-20]; and,

6 it also provided for a further revised refund formula, in the event that

7 “. . . the Commission does not approve the re-filed
8 [Infrastructure] Agreement . . .” [Letter Agreement at page 2,
9 lines 24-25]

10 Thus, by their own documentation, the parties to the Infrastructure Agreement
11 expressly acknowledged as of November 24, 1998 the Commission had not approved the
12 Infrastructure Agreement.

13 **C. Decision No. 63445 (March 13, 2001).**

14 On May 8, 2000, the parties to the Infrastructure Agreement entered into the First
15 Amendment thereto. Thereafter, on May 26, 2000, and in accordance with the 45-day
16 deadline provided for in the November 24, 1998 Letter Agreement, Citizens filed a Joint
17 Application with the Commission in which Citizens requested that the Commission
18 (i) extend the water and wastewater service CC&N granted in Decision No. 60975 to
19 include the 195-acre Jacka Parcel, and (ii) approve the First Amendment to the
20 Infrastructure Agreement.

21 On March 13, 2001, following a one (1)-day evidentiary hearing on the aforesaid
22 Joint Application, the Commission issued its Decision No. 63445. At various places within
23 the language of the decision, the Commission expressed its apparent understanding as to
24 the limited nature of the First Amendment:

25 “The purpose of the First Amendment is to include the Jacka
26 Parcel as part of the [Anthem] Project.” [Decision No. 63445
27 at page 3, lines 14-15] [emphasis added]

28 * * *

“In addition to the requested CC&N extension, the Applicants
also submitted for approval a copy of their First Amendment.
The purpose of the First Amendment is to include the Jack
Parcel and address the purchase of water from the Ak-Chin
Tribe.” [Decision No. 63445, Finding of Fact Nos. 16 and 17,
page 5 at lines 15-18] [emphasis added]

1 Accordingly, and on the basis of that understanding upon its part, the Commission
2 approved the First Amendment to the Infrastructure Agreement when it issued Decision
3 No. 63445.

4 However, by its very nature the language of that decision did not extend to nor
5 constitute a review and approval of the substantive provisions of the Infrastructure
6 Agreement itself. Moreover, any uncertainty as the limited nature and scope of the
7 Commission's approval in Decision No. 63445 was expressly clarified by the Commission
8 approximately fifteen (15) months later when it issued its Decision No. 64897 on June 5,
9 2002.

10 **D. Decision No. 64897 (June 5, 2002).**

11 On December 13, 2000, Citizens filed a Joint Application with the Commission in
12 which it set forth several requests, including a request that the Commission approve the
13 Infrastructure Agreement and the First and Second Amendments thereto. Once again,
14 Citizens asserted that

15 “... the provisions of ... the Infrastructure Agreement (as
16 amended by the First Amendment and the Second Amendment
17 thereto) ... are reasonable and in the public interest ...” [Joint
Application at page 5, lines 19-22]; and,

18 once again, the Commission declined to act upon Citizens request for review and approval
19 of the substantive provisions of the Infrastructure Agreement.

20 More specifically, and by way of background, in a December 4, 2001 Commission
21 Staff Report discussing the above-referenced Joint Application,⁷ the Commission's Staff
22 offered the following observations and recommendations in connection with the
23 Infrastructure Agreement and the subsequent amendments thereto:

24 “(4) The Anthem infrastructure agreement, dated September
25 29, 1997, is a private contract between Citizens, DistCo,

26 ⁷ The Commission Staff Report was filed in Docket Nos. WS-03454A-00-1022, WS-03455A-00-1022 and WS-
27 01032A-00-1022. The three (3) Citizens entities were (i) the original December 13, 2000 Joint Applicants (Citizens
28 Water Resources Company of Arizona and Citizens Water Services Company of Arizona) and (ii) Citizens
Communications Company, which apparently subsequently became an applicant.

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TreatCo, Del Webb Corporation (“Webb”), and Anthem Arizona, L.L.C. (“Developer”). This agreement provides terms and conditions under which DistCo will provide potable water distribution and wastewater collection services for Anthem. TreatCo will provide water and wastewater treatment services that will enable the provision of potable water distribution and wastewater collection services by DistCo along with the provision of non-potable water distribution services by TreatCo. Additionally, the agreement provides terms, conditions, and obligations for the other parties to the agreement. This agreement includes unequal refunding structures, cost caps, priority services, and penalties that may not be in line with this Commission’s standards.

The Commission originally chose not to consider any determination regarding the requested approval of the Anthem infrastructure agreement in Decision No. 60975. The Commission subsequently approved the first amendment to the agreement but not the infrastructure agreement itself in Decision No. 63445. Since the infrastructure agreement itself was not approved, approval of the amendment was apparently a misunderstanding. Therefore, Staff does not recommend that the Commission consider approval of the infrastructure agreement and its amendments. The Commission protects its rights to set rates and conditions it deems necessary to protect public interests by declining to approve this infrastructure agreement. This agreement is a private contract and, as such, does not require Commission approval or denial. Staff recommends that no action be taken on this issue. [Staff Report at page 3, lines 7-28] [emphasis added]

* * *

“Staff recommends that a complete legal review of all the agreements and the amendments be performed, in the event that the Commission chooses to take action on the aforementioned agreements and amendments, prior to such action.” [Staff Report at page 4, lines 7-9] [emphasis added]

* * *

“(4) Staff further recommends that the Commission take no action on the Anthem water/wastewater infrastructure agreement and its amendments. Staff believes that Commission approval is not necessary.” [Staff Report at page 4, lines 19-21]

On June 4, 2002, the ACC issued Decision No. 64897 in the proceeding in question. The following excerpts clearly indicate that the ACC followed the recommendation of the ACC Staff:

1 “We agree with Staff that there was no intent in Decision No.
2 63445 to approve the substance of the original Infrastructure
3 Agreement. In Decision No. 60975, the Commission adopted
4 Staff’s recommendation to “not consider any determination
5 regarding the requested approval of the Infrastructure
6 Agreement” (Decision No. 60975, at 6, 15). In Decision No.
7 63445, the Commission, in approving the First Amendment,
8 specifically stated that “[t]he purpose of the First Amendment
9 is to include the Jacka Parcel as part of the Project” (Decision
10 No. 63445, at 3). There was no further discussion of any other
11 aspect of the Infrastructure Agreement in that Decision and no
12 indication by the Commission that any of the other terms or
13 conditions of the original Infrastructure Agreement were being
14 approved. Reading the Decisions *in pari materia* leads to the
15 conclusion that the Commission did not intend to approve any
16 part of the Infrastructure Agreement, except for the First
17 Amendment’s addition of the Jacka Parcel to Citizens’
18 certificated territory.

19 There are other reasons for declining to approve the
20 Infrastructure Agreement in this proceeding. Staff points out
21 that the Agreement is a private contract between the
22 Companies and a third party developer that contains “unequal
23 refunding structures, cost caps, priority services, and
24 penalties” that may be inconsistent with the Commission’s
25 standards (Staff Report at 3). According to Staff, the
26 Infrastructure Agreement does not require the Commission’s
27 approval and, by not making a determination regarding the
28 Agreement, the Commission “protects its rights to set rates
and conditions it deems necessary to protect public interest”
(*Id.*). [Decision No. 64897 at page 6, lines 1-18] [emphasis
added]

18 Accordingly, on three (3) separate occasions Citizens had requested Commission review
19 and approval of the substantive (including refund obligation) provisions of the
20 Infrastructure Agreement and subsequent amendments thereto; and, on three (3) separate
21 occasions the Commission expressly declined to do so.

22 **E. Decision No. 70372 (June 13, 2008).**

23 The next Commission proceeding in which the Infrastructure Agreement and
24 amendments appear to have been referenced was a 2005 test period rate case proceeding
25 which involved AAWC, the successor-in-interest to Citizens under the Infrastructure
26 Agreement. In that regard, by means of a December 12, 2002 Third Amendment to the
27 Infrastructure Agreement, Del Webb, its affiliate Anthem Arizona, L.L.C. and AAWC
28 expressly acknowledged the assignment to AAWC of the rights (and obligations) of the

1 Citizens parties under the Infrastructure Agreement; and, they “ratified, confirmed and
2 approved” the Infrastructure Agreement, except as amended by the Third Amendment as to
3 other matters not pertinent to the instant analysis.

4 Under the section heading of “Other Issues,” the Infrastructure Agreement and
5 related amendments were discussed at pages 36-43 of Decision No. 70372. In that regard,
6 the following excerpts from that decision delineate the manner in which the subject of the
7 Infrastructure Agreement was addressed:⁸

8 “Public comments, both oral and written, in opposition to the
9 rate increase requested by Arizona-American’s application
10 expressed displeasure that the Company’s proposed rates
11 reflect repayment by Arizona-American to Pulte for
12 infrastructure costs paid by Pulte, and particularly, that
13 existence of the advances was not disclosed to homebuyers at
14 the time of purchase.” [Decision No. 70372 at page 40, lines
15 12-15] [emphasis added]

16 * * *

17 “Staff states on brief that it believed it important in this case
18 to develop a record on the Anthem Agreements and their
19 impact upon utility rates, because of the likelihood that Pulte
20 will have exited the development by the time Arizona-
21 American files its next rate case for the districts. Staff
22 believes that the two most significant issues raised in this
23 proceeding in regard to the Anthem Agreements were notice
24 to ratepayers regarding the allocation of water infrastructure
25 costs, and the reasonableness of the agreement to refund 100
26 percent of those costs to Pulte. Staff points out that Pulte
27 agreed to further concessions in the Fourth Amendment
28 because of concerns raised by Commissioners during the
hearings in this case. Staff further points out that the
agreements between the Company and the developer have
never been approved by the Commission, and that the
Commission may wish to address the reasonableness of the
Company’s agreement to refund to Pulte almost all of the
water infrastructure costs either in this case, or in the next
rate case the Company files for these districts, because the
next rate case will likely address the issue of the remaining
payment to Pulte” [Decision No. 70371 at page 40, line 17-
page 41, line 1] [emphasis added]

⁸ In that regard, for purposes of the instant analysis, the terms Infrastructure Agreement (and subsequent amendments) and Anthem Agreements are synonymous.

1 However, ultimately, the Commission did not resolve either of the two (2) aforementioned
2 issues, nor any other issues regarding the status or ratemaking treatment of the
3 Infrastructure Agreement and the amendments thereto, as indicated by the following
4 statements:

5 “At this time, no party has alleged, and we do not find, that the
6 Company’s repayment of developer advances under the
7 Anthem Agreement has been imprudent or improper.”
[Decision No. 70372 at page 43, lines 11-13] [emphasis
added]

8 * * *

9 “[However,] Our determination in this case is not intended to
10 have any bearing on our determination in any subsequent case
11 filed by the Company for these districts regarding the
12 reasonableness of the Company’s agreement to refund to Pulte
almost all of the costs required to construct Anthem’s water
infrastructure.” [Decision No. 70372 at page 43, lines 20-23]
[emphasis added]

13 Thus, in effect, the Commission “teed up” that issue for consideration in the instant
14 proceedings, as well as any other issues regarding the status or ratemaking treatment of the
15 Infrastructure Agreement and amendments thereto; and, as a party in the instant
16 proceedings, Anthem has decided to raise those issues at this time.

17 **III.**

18 **CITIZENS AND AAWC HAVE FAILED TO OBTAIN THAT APPROVAL**
19 **OF THE INFRASTRUCTURE AGREEMENT REQUIRED BY ARIZONA**
20 **LAW AND THE COMMISSION’S RULES AND REGULATIONS⁹**

21 **A. Failure to Comply with A.R.S. §§ 40-301 et seq.**

22 **1. Relevant Statutory Background**

23 The legal ability of a public service corporation to incur long-term financial
24 obligations and to issue evidence of indebtedness is subject to regulation and prior approval
25

26 ⁹ None of the four (4) amendments to the Infrastructure Agreement create the predicate financial obligation which is
27 the subject of the analysis set forth in Section II(A) of this Pre-Hearing Memorandum. Moreover, to the extent any of
28 the Amendments have a bearing upon such predicate financial obligation, this Section III clearly demonstrates that the
Commission also has not approved any of the Amendments. Accordingly, in the interest of brevity, the reference
herein will be only to the Infrastructure Agreement itself in connection with such analysis.

1 by the Commission, as indicated by the following statutory provisions:

2 “40-301. Issuance of stocks and bonds; authorized purposes

3 A. The power of public service corporations to issue stocks
4 and stock certificates, bonds, notes and other evidences of
5 indebtedness, and to create liens on their property located
6 within this state is a special privilege, the right of supervision,
7 restriction and control of which is vested in the state, and such
8 power shall be exercised as provided by law and under rules,
9 regulations and orders of the commission.

10 B. A public service corporation may issue stocks and stock
11 certificates, bonds, notes and other evidences of indebtedness
12 payable at periods of more than twelve months after the date
13 thereof, only when authorized by an order of the commission.

14 C. The commission shall not make any order or supplemental
15 order granting any application as provided by this article
16 unless it finds that such issue is for lawful purposes which are
17 within the corporate powers of the applicant, are compatible
18 with the public interest, with sound financial practices, and
19 with the proper performance by the applicant of service as a
20 public service corporation and will not impair its ability to
21 perform that service.” [emphasis added]

22 * * *

23 “40-302. Order authorizing issuance of stocks, bonds or other
24 evidences of debt; hearing on application to issue; amount of
25 issue; issuance of short term notes without commission order;
26 capitalization of certain items prohibited; accounting for
27 proceeds of issues

28 A. Before a public service corporation issues stocks and stock
certificates, bonds, notes and other evidences of indebtedness,
it shall first secure from the commission an order authorizing
such issue and stating the amount thereof, the purposes to
which the issue or proceeds thereof are to be applied, and that,
in the opinion of the commission, the issue is reasonably
necessary or appropriate for the purposes specified in the
order, pursuant to section 40-301, and that, except as
otherwise permitted in the order, such purposes are not, wholly
or in part, reasonably chargeable to operative expenses or to
income. Before an order is issued under this section, notice of
the filing of the application for such order shall be given by
the commission or the applicant in such form and manner as
the commission deems appropriate. The commission may hold
a hearing, and make inquiry or investigation, and examine
witnesses, books, papers and documents, and require filing
data it deems of assistance.

B. The commission may grant or refuse permission for the
issue of evidences of indebtedness or grant the permission to
issue them in a lesser amount, and may attach to its permission
conditions it deems reasonable and necessary. The
commission may authorize issues less than, equivalent to or
greater than the authorized or subscribed capital stock of the
corporation, and the provisions of the general laws of the state

1 with reference thereto have no application to public service
2 corporations.” [emphasis added]

3 * * *

4 “40-303. Validity of stock certificates or evidences of
5 indebtedness; violation of law or commission authorizations;
6 classification

7 A. All stock and every stock certificate, and every bond, note
8 or other evidence of indebtedness of a public service
9 corporation, issued without a valid order of the commission
10 authorizing the issue, or if issued with the authorization of the
11 commission but not conforming to the order of authorization
12 of the commission, is void, but no failure in any other respect
13 to comply with the terms or conditions of the order of
14 authorization of the commission shall make the issue void,
15 except as to a person taking the issue other than in good faith
16 and for value and without actual notice.” [emphasis added]

17 **2. “Evidence of Indebtedness”**

18 The Infrastructure Agreement is unequivocally “evidence of indebtedness” upon the
19 part of Citizens, and upon the part of AAWC as Citizens successor-in-interest thereunder.

20 In that regard, Recital “F” of the Infrastructure Agreement provides that

21 “With respect to the costs associated with obtaining those
22 water rights and constructing that infrastructure [necessary to
23 provide potable water distribution and wastewater collection
24 services, and water and wastewater treatment services] the
25 Parties¹⁰ desire that:

26 [i] The Citizens Parties will fund up to \$24,000,000 of
27 those costs

28 [ii] The Webb Parties will fund the balance of the costs.

[iii] The Parties will be reimbursed for those costs.”
[emphasis added]

The allocation of responsibility among the Parties for constructing such infrastructure is set forth in another table included within the Infrastructure Agreement, a copy of which is attached hereto as Appendix “C,” and is incorporated herein by this reference.¹¹ Attached

¹⁰ Attached hereto as Appendix “B” and incorporated herein by this reference is a copy of a table included within the Infrastructure Agreement, which identifies and defines for purposes of the Infrastructure Agreement each of the legal entities which comprise the “Webb Parties” and the “Citizens Parties,” respectively. The “Webb Parties” consist of Del Webb Corporation (“Webb”) and The Villages of Desert Hills, Inc. (“Developer”). The Citizens Parties consist of Citizens Utilities Company (“Citizens”), Citizens Water Services Company of Arizona (“DistCo”) and Citizens Water Resources Company of Arizona (“TreatCo”).

¹¹ In that regard, Sections 2.5 and 2.7 of the Infrastructure Agreement obligate Developer to design, construct and

1 hereto as Appendix "D" and incorporated herein by this reference is a copy of a third table
2 included within the Infrastructure Agreement which depicts responsibility for certain of the
3 advances and reimbursement thereof which are contemplated by the Infrastructure
4 Agreement.

5 Article III of the Infrastructure Agreement prescribes payment of advances and
6 refund obligations among the parties. In that regard, and as relevant to the instant analysis,
7 Section 3.1(c)-(e) provide as follows:

8 "c. Payment Obligations of the Citizens Parties.

9 The following are among the monetary obligations of the
10 Citizens Parties under this Agreement:

11 i. TreatCo will reimburse Developer for Construction
12 Costs for the Phase I Facilities and the Backbone Facilities, for
13 costs associated with acquiring certain real property interests
14 and utility easements, and for the Ak-Chin Water Lease Costs
15 (i.e., the amounts described in clauses (a) (i) through (a)
16 (iv) above). (The reimbursement procedure is described in
17 Section 8.12.)

18 ii. TreatCo will pay to third parties Construction Costs
19 for the Subsequent Facilities (as described in Section 8.6).

20 iii. The maximum aggregate amount to be reimbursed
21 or paid by TreatCo under and for purposes described in
22 clauses (i) and (ii) above will not exceed \$24,000,000.

23 iv. Citizens must pay to TreatCo the amounts described
24 in clauses (i) and (ii) above.

25 v. The maximum aggregate amount to be paid by
26 Citizens under and for the purposes described in clause
27 (iv) will not exceed \$24,000,000.

28 vi. In addition, TreatCo will refund Advances (as
described in paragraph (e) below).

d. Citizens Advances. For purposes of this Agreement,
29 "Citizens Advances" means the amounts described in clause
30 (c) (iv) above that are paid by Citizens.

e. Refunds of Advances. In accordance with Exhibit B:¹²

31 i. TreatCo will refund to Developer the Developer's
32 Advances.

33 ii. TreatCo will refund to Citizens the Citizens'
34 Advances. [emphasis added]

35 transfer to TreatCo (i) the Phase I Off-Site Facilities, (ii) the Phase I Production and Treatment Facilities, and (iii) the
36 Backbone Facilities necessary to extend water and wastewater services to the Villages at Desert Hills (Anthem)
37 Project.

38 ¹² A copy of the refund formula attached to the Infrastructure Agreement as Exhibit B is attached hereto as Appendix
"E," and is incorporated herein by this reference.

1 In addition, Section 3.3(d)-(h) of the Infrastructure Agreement provide in pertinent part as
2 follows:

3 “d. Notwithstanding the foregoing, the amount that Developer
4 will pay TreatCo under paragraph (c) above will not exceed
5 the amount of the unrefunded Citizens’ Advances at the
6 Performance Date.

7 e. Promptly upon receipt of a payment from Developer under
8 paragraph (c) above, TreatCo will pay Citizens, as an
9 accelerated Refund, the amount so received. Upon that
10 payment to Citizens, TreatCo will cause its records to reflect
11 the change in the outstanding amounts, by reducing the
12 Citizens’ Advances and increasing the Developer’s Advances
13 by the amounts so received by TreatCo from Developer.

14 f. All Refunds made by TreatCo after the Performance Date
15 will be made to Citizens 100%, until all of Citizens’ Advances
16 have been refunded. If necessary to ensure that Citizens does
17 not received a Refund in excess of its unrefunded Citizens’
18 Advances, TreatCo will prorate a Refund between Citizens
19 (under this paragraph (f)) and Developer (under paragraph (9)
20 below).

21 g. Once all of Citizens’ Advances have been refunded, 100%
22 of the future Refunds by TreatCo will be made to Developer.

23 h. As modified in paragraphs (e) through (g) of this Section,
24 the obligation of TreatCo to make Refunds under Exhibit B
25 will continue.” [emphasis added]

26 The Merriam-Webster Dictionary¹³ defines “indebted” as “owing money,” and,
27 “indebtedness” represents a form of being “indebted.” In that regard, it is abundantly clear
28 from the preceding analysis that Citizens and TreatCo each contractually obligated itself to
pay Developer, third parties and one another certain amounts of money over a period of
time in excess of twelve (12) months. As a consequence, the Infrastructure Agreement
unequivocally constitutes “evidence of indebtedness,” as contemplated within the language
and intent of A.R.S. §§ 40-301 *et seq.* The fact that such amounts were to be prospectively
quantified by means of the refund payment formula set forth in Exhibit B to the
Infrastructure Agreement does not in any manner alter the fact that the Infrastructure
Agreement itself was “evidence of indebtedness” requiring prior Commission approval

¹³ See <http://www.merriam-webster.com/>.
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1 pursuant to A.R.S. §§ 40-301(A) and 40-302(A). The ratemaking consequences of the
2 failure to obtain the requisite prior approval, when examined within the context of the
3 instant proceedings, are discussed in Section III(A) (4) of this Pre-Hearing Memorandum.

4 3. “Private Contract”

5 Characterization

6 In both the December 4, 2001 Commission Staff Report in Docket Nos. WS-
7 03454A-00-1022, WS-03455A-00-1022 and WS-01032A-00-1022, and in the
8 Commission’s subsequent June 4, 2002 Decision No. 64987 in those dockets, the
9 Infrastructure Agreement was characterized as a “private contract” not requiring
10 Commission approval at that time. Anthem respectfully submits that the conclusion
11 resulting from that characterization was in error.

12 More specifically, the fact that the signatory parties to the Infrastructure Agreement,
13 which created the obligation(s) of Citizens and TreatCo to make refunds over an extended
14 period of time, were private parties does not mean that the Infrastructure Agreement was
15 not in the nature of “evidence of indebtedness,” as contemplated by A.R.S. §§ 40-301 *et*
16 *seq.* Both Citizens and TreatCo were public service corporations under Arizona law, as
17 attested to by the CC&Ns granted to them by the Commission’s June 19, 1998 Decision
18 No. 60975 in connection with the inception of the Villages at Desert Hills (Anthem)
19 Project; and, thus they were subject to the requirements of A.R.S. §§ 40-301 *et seq.* for
20 prior Commission approval of the financial obligations created by the Infrastructure
21 Agreement.

22 In that regard, for purposes of an A.R.S. §§ 40-301 *et seq.* requirements analysis, a
23 meaningful distinction exists between the instant fact situation and a scenario under which
24 an Arizona public service corporation first obtains Commission approval to incur long-term
25 indebtedness and thereafter executes one (1) or more agreements providing for creation of
26 the authorized indebtedness. In each instance, the parties to the financing agreement(s) are
27 private entities, and the agreements might correctly be characterized as “private contracts.”
28 Similarly, both the Infrastructure Agreement and the above-hypothecated subsequently-

1 executed financing agreement(s) are each “evidence of indebtedness” within the context of
2 A.R.S. §§ 40-301 *et seq.* The crucial distinction, however, is the fact that, in the
3 circumstances of the Infrastructure Agreement, the requisite prior Commission approval
4 was not, and never has been obtained. That distinction cannot be ignored; and, that failure
5 cannot be legally excused under A.R.S. §§ 40-301 *et seq.* simply because the signatory
6 parties to the Infrastructure Agreement are private entities.

7 Finally, it should be noted that the “private contract” between the Webb Parties and
8 the Citizens Parties was one with substantial public interest implications, given the refund
9 obligations which were being incurred by Citizens and TreatCo thereunder. A.R.S. §§ 40-
10 301(C) contemplates that the Commission shall determine whether the proposed
11 indebtedness

12 “... is for lawful purposes which are ... compatible with the
13 public interest ...”

14 In this instance, that determination has never been made with regard to the several
15 advances and refund arrangements provided for in the Infrastructure Agreement; and, given
16 the concern expressed by the Commission’s Staff in the aforesaid December 4, 2001
17 Commission Staff Report, and reiterated by the Commission in Decision No. 64897 with
18 regard to

19 “... unequal refunding structures [in the Infrastructure
20 Agreement] ... that may be inconsistent with the Commission
21 standards.” [Decision No. 64897 at page 6, lines 14.5-15.5]
[emphasis added]

22 a serious question exists as to whether the Commission would have approved the
23 Infrastructure Agreement had the Citizens Parties properly presented it to the Commission
24 on those several occasions when they “generally” requested Commission approval of the
25 same.

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4. Ratemaking Consequences of
Failure to Obtain Requested A.R.S. §§ 40-301 et seq. Approval

In connection with the foregoing, Section 2.4 and Article VI of the Infrastructure Agreement obligate the Citizens Parties to

“ . . . take all reasonable steps necessary to obtain, maintain and renew any Authorizations . . . ”

which may be necessary for the contemplated multi-party arrangement to proceed; and, Exhibit A to the Infrastructure Agreement defines “Authorizations” as

“certificates of convenience and necessity, permits, licenses, operating agreements, franchises, and similar authorizations obtained from regulatory agencies and other governmental entities and required by law to provide DistCo Services and TreatCo Services and to operate the Facilities as contemplated herein.”

However, this “reasonable steps” language cannot, and does not, excuse the failure of the Citizens Parties to obtain that prior approval by the Commission of the Infrastructure Agreement required by A.R.S. §§ 40-301(A) and 40-302(A). Those statutory provisions do not contemplate nor speak in terms of “reasonable steps” and “best efforts” by an applicant proceeding thereunder. Rather, the requirement that Commission approval be obtained in advance of incurring the indebtedness in question is absolute.

Given such failure, AAWC (as Citizens successor-in-interest) should not now be allowed (i) to include in rate base, or (ii) to obtain related ratemaking recognition of the disputed refund payments made by AAWC to Pulte (as Webb’s successor-in-interest). Both the Citizens Parties and AAWC are large corporations with ready access to competent legal counsel. Each should have sought legal advice from legal counsel as to the specific type(s) of Commission approval of the Infrastructure Agreement which were necessary before entering into and thereafter discharging the financial obligations created by that document. Their apparent respective failure to either seek or adhere to such legal advice cannot and should not now be condoned or forgiven.

1 Having failed on several occasions to obtain Commission approval of the
2 Infrastructure Agreement, Citizens nevertheless proceeded to incur and discharge its
3 financial obligations thereunder.¹⁴ Subsequently, by means of its December 12, 2002
4 execution of the Third Amendment to the Infrastructure Agreement, AAWC expressly
5 acknowledged and

6 “. . . ratified, confirmed and approved . . .”
7 its financial obligations to Del Webb under the Infrastructure Agreement as Citizens
8 successor-in-interest; and, AAWC presumably did so with the knowledge that
9 approximately six (6) months earlier the Commission had indicated its concern in Decision
10 No. 64897 with

11 “. . . unequal refunding structures [in the Infrastructure
12 Agreement] . . . that may be inconsistent with the Commission
13 standards.” [Decision No. 64897 at page 6, lines 14.5-15.5]
14 [emphasis added]

15 Given the foregoing discussion, it is reasonable to conclude that both Citizens and
16 AAWC knowingly elected to proceed “at risk” with regard to whether or not any refund
17 payments they made to Webb or Pulte should be accorded (i) inclusion in rate base and
18 (ii) related ratemaking recognition in subsequent rate cases. In that regard, the issue of
19 failure to comply with the requirements of A.R.S. §§ 40-301 *et seq.* does not appear to have
20 been raised in any previous rate proceedings involving the Anthem Water District and the
21 Anthem/Agua Fria Wastewater District. However, Anthem is raising it in the instant

22 ¹⁴ In that regard, Section 14.16 of the Infrastructure Agreement provides that

23 “This Agreement is subject to approval by the Commission on or before August
24 15, 1998.”

25 As noted above in Section II(A) of this Pre-Hearing Memorandum, in its June 19, 1998 Decision No. 60975, the
26 Commission expressly declined to grant Citizens’ request for approval of the Infrastructure Agreement. Thereafter,
27 that failure to obtain such approval was acknowledged in the November 24, 1998 Letter Agreement between Citizens,
28 Del Webb and Anthem Arizona, L.L.C.; and, provision was made for Citizens to renew its request for approval within
45 days after execution of the contemplated First Amendment to the Infrastructure Agreement. That subsequent
request for renewal was a subject of Decision No. 63445, as discussed in Section II(C) above; and, as discussed in
Section II(D) above, in its June 5, 2002 Decision No. 64897, the Commission expressly stated that at no time
(including in Decision No. 63445) had it ever approved the Infrastructure Agreement.

1 proceedings; and, it is Anthem’s position that disputed refund payments to Pulte should
2 (i) be permanently excluded from AAWC’s rate base and (ii) not accorded any related
3 ratemaking recognition by reason of such failure.

4 **B. Failure To Comply With A.A.C. R14-2-406.**

5 **1. Relevant Regulatory Background**

6 A.A.C. R14-2-406 of the Commission’s rules and regulations for water utilities
7 governs the subject of Main Extension Agreements, as well as off-site and “backbone”
8 facilities in connection with the provision of water service. In that regard, A.A.C. R14-2-
9 406 provides in pertinent part as follows:

10 **“R14-2-406. Main extension agreements**

- 11 **A. Each utility entering into a main extension agreement shall**
12 **comply with the provisions of this rule which specifically**
13 **defines the conditions governing main extensions.**
- 14 **B. An applicant for the extension of mains may be required to**
15 **pay to the Company, as a refundable advance in aid of**
16 **construction, before construction is commenced, the**
17 **estimated reasonable cost of all mains, including all valves**
18 **and fittings.**
- 19 **1. In the event that additional facilities are required to**
20 **provide pressure, storage or water supply, exclusively**
21 **for the new service or services requested, and the cost**
22 **of the additional facilities is disproportionate to**
23 **anticipated revenues to be derived from future**
24 **consumers using these facilities, the estimated**
25 **reasonable cost of such additional facilities may be**
26 **included in refundable advances in aid of construction**
27 **to be paid to the Company.” [emphasis added]**

19 * * *

- 21 **D. Refunds of advances made pursuant to this rule shall be**
22 **made in accord with the following method:** the Company
23 shall each year pay to the party making an advance under a
24 main extension agreement, or that party’s assignees or
25 other successors in interest where the Company has
26 received notice and evidence of such assignment or
27 succession, a minimum amount equal to 10% of the total
28 gross annual revenue from water sales to each bona fide
consumer whose service line is connected to main lines
covered by the main extension agreement, for a period of
not less than 10 years. Refunds shall be made by the
Company on or before the 31st day of August of each
year, covering any refunds owing from water revenues
received during the preceding July 1st to June 30th period.
A balance remaining at the end of the ten-year period set

1 out shall become non-refundable, in which case the
2 balance not refunded shall be entered as a contribution in
3 aid of construction in the accounts of the Company,
4 however, agreements under this general order may provide
5 that any balance of the amount advanced thereunder
6 remaining at the end of the 10 year period set out, shall
7 thereafter remain payable in whole or in part and in such
8 manner as is set forth in the agreement. The aggregate
9 refunds under this rule shall in no event exceed the total of
10 the refundable advances in aid of construction. No interest
11 shall be paid by the utility on any amounts advanced. The
12 Company shall make no refunds from any revenue
13 received from any lines, other than customer service lines,
14 leading up to or taking off from the particular main
15 extension covered by the agreement.

16 E. Amounts advanced in aid of construction of main
17 extensions shall be refunded in accord with the rules of
18 this Commission in force and effect on the date the
19 agreement therefor was executed. All costs under main
20 extension agreements entered into after the adoption of
21 this rule shall be refunded as provided herein.” [emphasis
22 added]¹⁵

23 * * *

24 M. All agreements under this rule shall be filed with and
25 approved by the Utilities Division of the Commission. No
26 agreement shall be approved unless accompanied by a
27 Certificate of Approval to Construct as issued by the
28 Arizona Department of Health Services. Where
agreements for main extensions are not filed and approved
by the Utilities Division, the refundable advance shall be
immediately due and payable to the person making the
advance.”¹⁶ [emphasis added]

15 The provisions of R14-2-406 discussed in Section III(B) of this Pre-Hearing Memorandum have not changed in substantive content since the regulation was adopted by the Commission and became effective on March 2, 1982.

16 The Commission’s regulation (A.A.C. R14-2-606) governing sewer collection main extension agreements adopts a different approach with regard to advances in-aid-of construction and refunds. This approach includes reference to the utility’s sewer extension tariff, a maximum footage and/or equipment allowance, and an economic feasibility analysis for sewer main extensions in excess of the maximum footage and/or equipment allowance. No such economic feasibility analysis appears to have been submitted in connection with the original request for Commission approval of the Infrastructure Agreement. Moreover, the timeline for and content of the refund formula set forth in Exhibit B to the Infrastructure Agreement do not comply with A.A.C. R14-2-606(C)(5), which provides:

“If after five years from the utility’s receipt of the advance, the advance has not been totally refunded, the advance shall be considered a contribution in aid of construction and shall no longer be refundable.” [emphasis added]

Thus, even if it be assumed for discussion purposes that express Commission approval of the Infrastructure Agreement refund arrangement for sewer and wastewater infrastructure was not required, a waiver of or variance from A.A.C. R14-2-606(C)(5) would have been necessary; and, there is no record of such a waiver or variance ever having been granted by the Commission. Accordingly, all funds advanced for sewer and wastewater infrastructure which had not

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4. Ratemaking Consequences

Of Failure to Obtain Requisite A.A.C. R14-2-406 Approval

A.A.C. R14-2-406(D) prescribes a 10 percent/10 year refund formula that is to be used as a guideline for the refund of advances in-aid-of construction. It also allows for alternative refund arrangements, provided that the prior Commission approval of the refund arrangement required by A.A.C. R14-2-406(M) has been obtained. In addition, A.A.C. R14-2-406 requires that advances made under the provisions of an agreement which has not been previously approved

“ . . . shall be immediately due and payable to the person making the advance.”

Thus, the question to be addressed at this time is what should be the ratemaking consequence of the failure of Citizens and AAWC to obtain that prior approval of the Infrastructure Agreement required under A.A.C. R14-2-406, given that (i) the refund formula provided for in the Infrastructure Agreement is substantially different from the guideline set forth in A.A.C. R14-2-406(D), and (ii) virtually all of the funds advanced under the Infrastructure Agreement have already been refunded. Anthem submits that the appropriate means for resolving that question is to (i) permanently exclude from AAWC’s rate base, and (ii) deny any associated ratemaking recognition of the disputed refund payments made by AAWC to Pulte.¹⁸

More specifically, while the language of A.A.C. R14-2-406(D) suggests that there may be variations of the 10 percent/10 year formula therein prescribed, A.A.C. R14-2-406(M) clearly indicates that approval of such variation by the Commission’s Utilities Division is a regulatory prerequisite to implementation of the same. In this instance, such

cannot and does not legally excuse the failure of both Citizens and AAWC to comply with the prior approval requirement of A.R.S. §§ 40-301 *et seq.*

¹⁸ The same question and suggested means for resolution apply by analogy to their failure to obtain a “waiver” of the otherwise automatic conversion of an advance to a contribution in-aid-of construction provision under A.A.C. R14-2-606(C)(5).

1 approval was never obtained by Citizens or AAWC.¹⁹ Moreover, as discussed in Section
2 II(D) above of this Pre-Hearing Memorandum, in both (i) a December 4, 2001 Commission
3 Staff Report, and (ii) the Commission’s June 5, 2002 Decision No. 64897, a concern was
4 expressed that the Infrastructure Agreement contained

5 “... unequal refunding structures . . . that may be inconsistent
6 with the Commission’s standards. (Staff Report at 3).”
7 [Decision No. 64897 at page 6, lines 14.5-15.5] [emphasis
8 added]

9 As a consequence, it is reasonable to conclude that the Commission might never have
10 approved the refunding arrangement and formula provided for in the Infrastructure
11 Agreement, particularly since it contemplated and provided for a refund of virtually all of
12 the funds advanced under the Infrastructure Agreement without a supporting economic
13 feasibility analysis.

14 In that regard, A.A.C. R14-2-406(B) expressly recognizes that, in certain situations,

15 “. . . the cost of the additional [backbone] facilities is
16 disproportionate to anticipated revenues to be derived from
17 future customers using these facilities. . .”;

18 and, A.A.C. R14-2-406(M) requires that any proposed treatment of such additional costs as
19 refundable advances in-aid-of construction be subject to the requirement of prior
20 Commission approval. The prospect that “additional costs” of this nature were
21 contemplated by the original parties to the Infrastructure Agreement is confirmed by the
22 language of the agreement itself:

23 “2.10 Risk Borne by TreatCo. As provided in this Agreement,
24 TreatCo will bear (by funding up to \$24,000,000 of Phase I
25 Facilities, Backbone Facilities, Subsequent Facilities and
26 related costs, by certain rate moratoriums, rate-of-return cap
27 guarantees, and by the use of deferred depreciation methods) a
28 portion of the risk that the Project will not be developed as
quickly as anticipated by the Parties. As a result, initial DistCo
rates will be lower than if established under more traditional
Commission rate-setting principles and customers will not be
asked to bear the cost of prudent investment for future service

19 Similarly, an exception to the five (5)-year refund period, which A.A.C. R14-2-606(C)(5) effectively imposes upon sewer collection main extension agreements, would also require an exception by the Commission in the form of a “waiver” or “variance.” As noted above, it appears such a “waiver” or “variance” has never been obtained.

1 if actual customer additions occur at rates that are less than
2 projected customer additions.” [Infrastructure Agreement at
page 5] [emphasis added]

3 As indicated in Section III(A)(2) above of this Pre-Hearing Memorandum, pursuant to
4 Section 3.1(c)-(e) and Section 3.3(d)-(h) of the Infrastructure Agreement, virtually all of
5 the funds advanced by Developer and TreatCo for these “additional facilities” were
6 intended to ultimately be refunded to those entities through operation of the refund formula
7 attached to the Infrastructure Agreement as Exhibit B, which is in marked contrast to the 10
8 percent/10 year refund guideline set forth in A.A.C. R14-2-406(D).²⁰ Moreover, as also
9 noted above, the Commission has never approved the Exhibit B refund formula. Rather,
10 both the Commission and the Commission Staff have expressed concern with regard to the
11 “unequal refunding structures” provided for under the Infrastructure Agreement and
12 Exhibit B.

13 In addition, the “immediate refund” sanction provided for in A.A.C. R14-2-406(M),
14 in the event of the affected public service corporation’s failure to obtain the prerequisite
15 prior approval, is of no significance in the current situation. That is because virtually all of
16 the funds to be refunded pursuant to the Infrastructure Agreement and refund formula have
17 already been refunded. Given this circumstance, an appropriate regulatory sanction would
18 be (i) permanent exclusion from AAWC’s rate base and (ii) denial of related ratemaking
19 recognition of the disputed refund payments made by AAWC to Pulte.²¹

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26 ²⁰ Similarly, the twelve (12)-year refund period provided for in the November 24, 1998 Letter Agreement, discussed in
Section II(B) above, clearly and substantially exceeds the five (5) year refund period provided for in A.A.C. R14-2-
606(C)(5).

27 ²¹ In that regard, such permanent exclusion from rate base and denial of ratemaking recognition would appear to also
28 be consistent with the ratemaking treatment prescribed in A.A.C. R14-2-606(C)(5).

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IV.

**CITIZENS AND AAWC HAVE EACH ACTED UNREASONABLY,
IMPRUDENTLY, AND IMPROPERLY BY (i) FAILING TO OBTAIN THE
REQUISITE PRIOR COMMISSION APPROVAL OF THE INFRASTRUCTURE
AGREEMENT, AND (ii) MAKING REFUND PAYMENTS ON THE
BASIS OF ASSUMED LEGAL OBLIGATIONS**

Both Citizens and AAWC are well-established and multi-state utility enterprises, and each has a history of years of experience in the regulated monopoly context which antedates the September 29, 1997 Infrastructure Agreement. Each has the financial wherewithal to employ or retain competent legal counsel to advise it as to its legal and regulatory responsibilities under Arizona law; and, each has a responsibility to both its ratepayers and investors to timely and fully discharge those responsibilities. When the history of the Infrastructure Agreement is examined between the date of its 1997 inception and the present, it becomes readily apparent that both Citizens and AAWC failed to timely and fully discharge their respective legal and regulatory responsibilities with respect to obtaining Commission approval of the Infrastructure Agreement.

In the case of Citizens, it should have specifically requested Commission approval of the Infrastructure Agreement pursuant to both A.R.S. §§ 40-301 *et seq.* and A.A.C. R14-2-406 at the time that Citizens, DistCo and TreatCo filed their October 29, 1997 Joint Application requesting authorization to provide water and wastewater service to the Villages at Desert Hills (Anthem) Project. The prior Commission approval requirements of both A.R.S. §§ 40-301 *et seq.* and A.A.C. R14-2-406 were in existence at that time and presumably known to Citizens and its legal counsel; and, specific approval pursuant to those statutory and legal provisions should have been requested, but was not.²²

²² Similarly, a “waiver” or “variance” from the provisions of A.A.C. R-14-2-606(C)(5) should have been requested, and was not.

1 Moreover, when the Commission initially declined to address the Infrastructure
2 Agreement in its June 19, 1998 Decision No. 60975, the Citizens Joint Applicants should
3 have requested rehearing and specified why receipt of the aforesaid prior Commission
4 approvals was not only a statutory and regulatory prerequisite, but also a contractual
5 prerequisite to their ability to proceed with the Villages at Desert Hills (Anthem) Project.²³
6 However, for some unknown reason, the Citizens entities elected not to do so. Similarly, as
7 discussed in Section II(C) and (D) above of this Pre-Hearing Memorandum, the Citizen
8 entities thereafter again failed to receive Commission approval of the Infrastructure
9 Agreement; and, once again, they failed impress upon the Commission and its Staff the
10 statutory and regulatory necessity of addressing the status of the Infrastructure Agreement
11 within the specific context of A.R.S. §§ 40-301 *et seq.* and A.A.C. R14-2-406.²⁴

12 In the case of AAWC, it can be presumed that the Commission had
13 not approved the Infrastructure Agreement at the time it agreed to succeed to Citizens
14 responsibilities and obligations thereunder. As noted in Section II(D) above of this Pre-
15 Hearing Memorandum, in its March 13, 2001 Decision No. 64897, the Commission
16 indicated that as of that date it had not approved

17 “. . . any part of the Infrastructure Agreement, except for the
18 First Amendment’s addition of the Jacka Parcel to Citizens’
19 certificated territory.” [Decision No. 64897 at page 6, lines
20 10.5-11.5] [emphasis added]

21 ²³ As previously noted, Section 14.16 of the Infrastructure Agreement expressly provided that

22 “This Agreement is subject to approval by the Commission on or before August
23 15, 1998.” [emphasis added]

24 In that regard, Section 14.16(d) provided for the amendment or termination of the Infrastructure Agreement in the
25 absence of timely receipt of a Commission order approving the Infrastructure Agreement as contemplated by the
26 signatory parties. The only amendment of that nature appears to have been in the form of the November 24, 1998
27 Letter Agreement discussed in Section II(B) above of this Pre-Hearing Memorandum; and, subsequent events clearly
28 indicate that Del Webb never exercised its Section 14.16(d) right to terminate the Infrastructure Agreement by reason
of the failure to obtain Commission approval of the same. That being the case, Citizens and AAWC each should have
had added incentive to press for timely and definitive Commission action on the Infrastructure Agreement, given their
substantial refund obligations thereunder.

²⁴ As well as within the context of A.A.C. R14-2-606.

1 and, the Commission had therein indicated that

2 “There are other reasons for declining to approve the
3 Infrastructure Agreement in this proceeding. [since] Staff
4 points out that the Agreement . . . contains ‘unequal refunding
5 structures, cost caps, priority services and penalties’ that may
6 be inconsistent with the Commission standards . . .” [Decision
7 No. 64897 at page 6, lines 14.5-15.5] [emphasis added]

8 Nevertheless, and despite this knowledge of the Commission’s posture on the status of the
9 Infrastructure Agreement, which AAWC presumably acquired during its “due diligence”
10 relating to the contemplated acquisition of Citizens’ water and wastewater assets in
11 Arizona, AAWC entered into the December 12, 2002 Third Amendment to the
12 Infrastructure Agreement pursuant to which AAWC and Del Webb stated that the
13 Infrastructure Agreement

14 “is hereby ratified, confirmed and approved”

15 except as to modifications pursuant to the Third Amendment which are not relevant to the
16 instant analysis. Moreover, AAWC thereafter proceeded to make refunds pursuant to the
17 Infrastructure Agreement and refund formula therein provided, with the knowledge that
18 (i) the same had never been approved by the Commission and (ii) the Commission was
19 expressly concerned that the Infrastructure Agreement contained

20 “ . . . unequal refunding structures . . . that may be inconsistent
21 with the Commission standards . . .” [Decision No. 64897 at
22 page 6, lines 14.5-15.5] [emphasis added]

23 Further, AAWC did so with the knowledge that in Decision No. 64897 the Commission
24 also had stated that

25 “ . . . by not making a determination regarding the
26 [Infrastructure] Agreement, the Commission ‘protects its
27 rights to set rates and conditions it deems necessary to protect
28 the public interest’” [Decision 64897 at page 6, lines 16.5-
18.5]

in some future rate proceeding. In this instance, the “public interest” is synonymous with
the financial interests of AAWC’s Anthem Water District and Anthem/Agua Fria
Wastewater District ratepayers; and, that “future rate proceeding” is the instant
proceedings.

1 Against the preceding background, it can and should be concluded that both Citizens
2 and AAWC acted unreasonably, imprudently and improperly by (i) failing to explicitly
3 request and obtain the prior Commission approval of the Infrastructure Agreement required
4 by A.R.S. §§ 40-301 *et seq.* and A.A.C. R14-2-406, and (ii) proceeding to make refund
5 payments thereunder in the absence of such prior Commission approval. The Commission
6 is not in a position at this time to address the failure(s) of Citizens. However, it is in a
7 position to address the failure(s) of AAWC within the context of the instant proceedings;
8 and, it should do so by (i) permanently excluding from AAWC's rate base and (ii) denying
9 any associated ratemaking recognition of the disputed refund payments made by AAWC to
10 Pulte.

11 V.

12 CONCLUSION

13 For the reasons discussed above in Sections II through IV of this Pre-Hearing
14 Memorandum, Anthem hereby requests that in its ultimate Opinion and Order in the instant
15 proceedings the Commission (i) permanently exclude from AAWC's rate base and (ii) deny
16 any associated ratemaking recognition of the disputed refund payments made by AAWC to
17 Pulte.

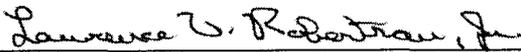
18 Dated this 16th day of April, 2010.

19 Respectfully submitted,

20 Judith M. Dworkin
21 Sacks Tierney PA
22 4250 North Drinkwater Blvd., 4th Floor
23 Scottsdale, Arizona 85251-3693

24 and

25 Lawrence V. Robertson, Jr.
26 P. O. Box 1448
27 Tubac, Arizona 85646-1448

28 
Attorneys for Anthem Community Council

1 The original and fifteen (15) copies of the
2 foregoing Pre-Hearing Memorandum will
be filed the 16th day of April, 2010 with:

3 Docket Control
4 Arizona Corporation Commission
1200 West Washington Street
5 Phoenix, Arizona 85007

6 A copy of the foregoing Pre-Hearing Memorandum
will be electronically transmitted/mailed/hand-delivered
7 the same date to:

8 Hearing Division
9 Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

10 All parties of record

11
12 
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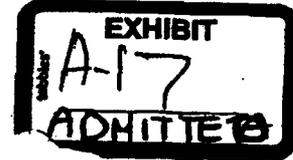
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Appendix “A”

**(Intervenor Anthem Community
Council’s Pre-Hearing Memorandum
on Disputed Refund Payment Issue)**

**Docket Nos. W-01303A-09-0343
and SW-01303A-09-0343**

Citizens Utilities
Three High Ridge Park
Stamford, CT 06905
203.614.5600



November 24, 1998

Del Webb Corporation
Attention: Manager
14901 North Scottsdale Road, Suite 200
Scottsdale, Arizona 85254

Anthem Arizona, L.L.C.
Attention: Manager
14901 North Scottsdale Road, Suite 200
Scottsdale, Arizona 85254

Re: Agreement for Anthem Water/Wastewater Infrastructure dated as of September 29, 1997, among Del Webb Corporation, Anthem Arizona, L.L.C. (successor by merger to Anthem Arizona, Inc., which was formerly known as The Villages at Desert Hills, Inc.), Citizens Utilities Company, Citizens Water Services Company of Arizona, and Citizens Water Resources Company of Arizona, as amended (the "Agreement") (with capitalized terms in this letter having the meanings given to them in the Agreement)

Dear Ladies and Gentlemen:

Preliminary Statement. Webb and Citizens have completed negotiations to resolve the consequences of two circumstances:

- a. The Agreement was not approved by the Arizona Corporation Commission on or before August 15, 1998 (see §14.16); and
- b. The parties have not entered into an agreement on or before May 31, 1998, with the City of Phoenix that grants DistCo and TreatCo the right to provide DistCo Services and TreatCo Services in the Phoenix Area (see § 6.3b).

As a result of these negotiations, Webb and Citizens have entered into this Letter Agreement and agree as follows:

1. Webb will make the annual payments to Citizens shown in Column 1 of the attached Exhibit A, beginning on July 1, 2004. The total payments by Webb to Citizens will not exceed \$9,150,000, if made on time each year. Payments that are more than 30 days past due will accrue interest from the due date at the rate set forth in Section 14.21 of the Agreement.
2. If by March 31, 1999, the City of Phoenix grants DistCo and TreatCo the right to provide DistCo Services and TreatCo Services in the Phoenix Area, Webb will instead make the annual payments to Citizens shown in Column 2 of the attached Exhibit A, beginning on July

CU/Webb.doc

1, 2004. The total payments by Webb to Citizens will not exceed \$13,800,000, if made on time each year. Payments that are more than 30 days past due will accrue interest from the due date at the rate set forth in Section 14.21 of the Agreement.

3. Webb's obligation to make the payments described in paragraphs [1] and [2] is suspended for such time as it is determined, under the dispute resolution provisions of Agreement Article XII that one of the Citizens Parties is in material default under the Agreement
4. The parties recognize and acknowledge that condemnation of all or substantially all of the Facilities would cause the Webb Parties to incur additional costs for which they would not be compensated under Agreement Article X. As a consequence, in such event, all remaining payments owed by Webb under this Letter Agreement will be eliminated. The parties also recognize and acknowledge that elimination of these payments would deprive the Citizens Parties of a material benefit expected from providing service to Anthem. Accordingly, any condemnation award should compensate Citizens for the payment elimination. A portion of such award, equal to the present value (using a 12% discount rate) of the payment elimination, will be allocated to Citizens after sufficient funds have been allocated under ¶ 10.1(b) of the Agreement, but before any remaining funds are allocated under ¶ 10.1(c) of the Agreement.
5. Within 45 days after execution of the First Amendment, Citizens will re-file for approval by the Arizona Corporation Commission of the Agreement, as amended by the First Amendment. Among other things, the First Amendment would fix, until Buildout, the Capacity Reservation Charge ("CRC") at \$1,530 per ERU [that is, \$765 per ERU for water service and \$765 per ERU for wastewater service] as defined in Section 3.2 of the Agreement. If the Commission does not approve the re-filed Agreement, including a fixed CRC of \$1530 until Buildout, the following adjustment will be made:
 - a. An adjustment (the "offset calculation"), up or down, will be made to the amount of the annual payment under either paragraph [1] or [2], above. This adjustment will equal (a) the number of connections by a Builder made in the year before the payment due date, times (b) the difference in the CRC ordered by the Commission in a future rate proceeding and the \$1,530 established in the initial rate approval in Decision No. 60975.
 - For example, if the Commission orders a CRC in the amount of \$1,730 per connected ERU, to be effective on January 1, 2008, the payment due by Webb in 2009 would be reduced by an amount equal to (a) \$200 times (b) the number of connected ERUs in 2008. Assuming that 700 ERUs were connected in 2008, such Builders would make the CRC payments to TreatCo in the amount of \$1,730 per connection, and the \$880,000 payment due on July 1, 2009, that is otherwise required under paragraph [1] above would be reduced by \$140,000 (\$200 incremental increase in the CRC, times 700 connections).
 - b. The offset calculation would apply only to Builders that are wholly-owned Webb subsidiaries and not to any joint ventures or other Builders where Webb is not the sole owner of the Builder.

6. The parties are currently in the process of negotiating an agreement with the City of Phoenix ("City") that would resolve issues resulting from the City's failure to grant DistCo and TreatCo the right to provide DistCo Services and TreatCo Services in the Phoenix Area. The parties will use their best efforts to support and promptly consummate the following transactions as part of such agreement ("Phoenix Agreement"):
- a. The City would provide water and wastewater service in the Phoenix Area.
 - b. Webb would construct or cause to be constructed, according to City standards, all facilities required to interconnect Anthem (including the Phoenix Area) with the City and to provide back-up water supply and the peaking water supply for Citizens' service to Anthem ("Interconnection Facilities").
 - c. Until such time as the Interconnection Facilities are constructed, Citizens would provide, under the Phoenix Agreement or a concurrent agreement, wholesale water and wastewater service to the City for its customers in the Phoenix Area.
 - d. Webb would construct, or cause to be constructed, the distribution facilities for City service in the Phoenix Area ("Phoenix-Area Facilities"). Webb would incur incremental costs associated with constructing the Phoenix-Area Facilities to City standards, rather than County standards, ("Incremental Costs").
 - e. The Interconnection Facilities and the Phoenix-Area Facilities would be transferred to the City.
 - f. The City would provide long-term and uninterrupted back-up and peaking services capacity for Citizens' service to Anthem. For the peaking services, the City would charge Citizens a capacity charge that is expected to be less than the total of
 - i. the capacity charge(s) that the City would otherwise charge Citizens for the necessary transportation and treatment capacity; and
 - ii. the carrying costs of the facilities that would be avoided by entering into an agreement with the City.

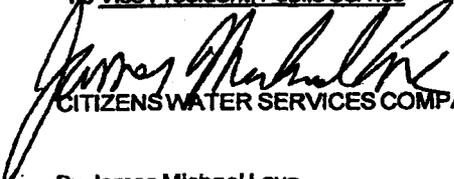
The City would also charge Citizens a volumetric charge for the operating and maintenance costs associated with water actually treated and provided to Citizens. The quality of such water should be equivalent to that provided by the City to other City residents.

- g. The City would fully compensate Webb for the construction costs of the Interconnection Facilities, the Incremental Costs and Webb's over-sizing costs for facilities already constructed.

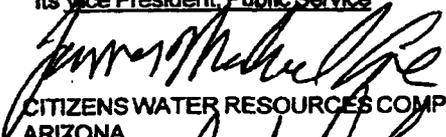
Very truly yours,


CITIZENS UTILITIES COMPANY

By James Michael Love
Its Vice President, Public Service


CITIZENS WATER SERVICES COMPANY OF ARIZONA

By James Michael Love
Its Vice President, Public Service


CITIZENS WATER RESOURCES COMPANY OF ARIZONA


By James Michael Love
Its Vice President, Public Service

Agreed as of November 30 1998:

DEL WEBB CORPORATION

By 
Its Sr. Vice President

ANTHEM ARIZONA, L.L.C.

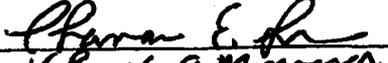
By 
Its V.P. & General Manager

EXHIBIT A

<u>LINE #</u>	<u>YEAR</u>	<u>PAYMENTS (Due On July 1, Each Year)</u>	
		<u>COLUMN 1</u>	<u>COLUMN 2</u>
		(No Phoenix-Area Service)	(Phoenix-Area Service)
1	2004	\$ 1,483,000	\$ 1,912,000
2	2005	1,320,000	1,749,000
3	2006	1,210,000	1,639,000
4	2007	1,100,000	1,528,000
5	2008	990,000	1,418,000
6	2009	880,000	1,308,000
7	2010	715,000	1,144,000
8	2011	600,000	1,028,000
9	2012	484,000	913,000
10	2013	358,000	797,000
11	2014	-0-	237,000
12	2015	-0-	122,000
13	2016	-0-	9,000
14	TOTAL	\$ 9,150,000	\$ 13,804,000

Appendix “B”

**(Intervenor Anthem Community
Council’s Pre-Hearing Memorandum
on Disputed Refund Payment Issue)**

**Docket Nos. W-01303A-09-0343
and SW-01303A-09-0343**

"Parties"

"Parties"			
"Webb Parties"		"Citizens Parties"	
Del Webb Corporation ("Webb")	The Villages at Desert Hills, Inc. ("Developer")	Citizens Utilities Company ("Citizens")	Citizens Water Services Company of Arizona ("DistCo")
			Citizens Water Resources Company of Arizona ("TreatCo")

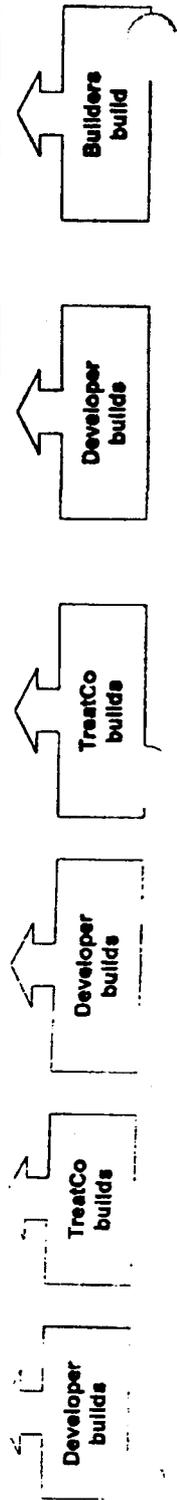
Appendix “C”

**(Intervenor Anthem Community
Council’s Pre-Hearing Memorandum
on Disputed Refund Payment Issue)**

**Docket Nos. W-01303A-09-0343
and SW-01303A-09-0343**

water/wastewater infrastructure

"Facilities"				"On-Site Facilities" (within Project)
"Off-Site Facilities" (delivery of raw water from Waddell Canal to Project)		"Production/Treatment Facilities" (within Project)		
"Phase I Off-Site Facilities"	"Subsequent Off-Site Facilities"	"Phase I Production/Treatment Facilities"	"Subsequent Production/Treatment Facilities"	<ul style="list-style-type: none"> • Potable Water distribution system • wastewater collection system
<ul style="list-style-type: none"> • Waddell Canal turn-out structure • Initial phase of raw water pumping station • Project Pipeline • All other items needed to deliver raw water to Project for initial water/wastewater service 	<ul style="list-style-type: none"> • Subsequent phase of raw water pumping station • Remaining items related to delivery of raw water to Project for additional water/wastewater service 	<ul style="list-style-type: none"> • Initial phase of raw water impounding reservoir • Initial phase of water treatment plant • Initial phase of wastewater treatment plant • Initial phase of effluent storage lagoons • Initial phase of water storage & booster facilities • Initial phase of recharge facility • Initial recovery & Potable Water wells • Related items 	<ul style="list-style-type: none"> • Remaining phase of raw water impounding reservoir • Remaining phase of water treatment plant • Remaining phase of wastewater treatment plant • Remaining phase of effluent storage lagoons • Remaining phase of water storage & booster facilities • Remaining phase of recharge facility • Remaining recovery & Potable Water wells • Remaining related items 	
<ul style="list-style-type: none"> • Transportation of Potable Water, Non-Potable Water or untreated wastewater: <ul style="list-style-type: none"> • between DistCo distribution/collection system & Production/Treatment Facilities of TreatCo • between TreatCo's Facilities & Non-Potable Water customers 				



Appendix “D”

**(Intervenor Anthem Community
Council’s Pre-Hearing Memorandum
on Disputed Refund Payment Issue)**

**Docket Nos. W-01303A-09-0343
and SW-01303A-09-0343**

"Advances"

"Developer's Advances"

"Citizens' Advances"
(not to exceed \$24 million)

(i)	Ak-Chin Water Lease Costs	(ii)	Construction Costs related to Phase I & Backbone Facilities paid to contractors	(iii)	Realty conveyed to TreatCo per \$8.1	(iv)	Utility easements & rights-of-way conveyed to TreatCo per \$14.2	(v)	Reimbursement to TreatCo of Construction Costs for Subsequent Facilities under \$8.13	(vii)	[Contingent] Payment to TreatCo if additional services increase its avg. rate base investment per customer under \$14.3(a)	(vii)	[Contingent] Crack-up payment to TreatCo under \$3.3(c)	(A)	Reimbursement to Developer of Items (i)-(iv)	(B)	Construction Costs paid to contractors for Subsequent Facilities
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Invoiced to TreatCo by Developer under \$8.12(a)

Invoiced to Developer by TreatCo under \$8.13(a)

Appendix “E”

**(Intervenor Anthem Community
Council’s Pre-Hearing Memorandum
on Disputed Refund Payment Issue)**

**Docket Nos. W-01303A-09-0343
and SW-01303A-09-0343**

EXHIBIT B

REFUNDS OF ADVANCES

1. TreatCo will pay to Citizens and Developer refunds of Citizens' Advances and Developer's Advances (collectively "Refunds") as follows:

a. Refunds in the amount of \$5,000 per ERU first taking service during a calendar year will be made on July 1 of the following year, the seventh month following the end of the calendar year of the ERU connection. For example, Refunds for ERU connections in 1999 will be due on July 1, 2000. Of this total refund amount, and subject to Sections 3.3(e), (f) and (g), 25% (\$1,250 per ERU) will be payable to Citizens and 75% (\$3,750 per ERU) will be payable to Developer.

b. Once at least 3,500 ERU have been connected, Refunds will retroactively increase by \$800 per ERU, and subsequent Refunds will be in the amount of \$5,800 per ERU until 7,000 ERU have been connected. The payment made on the July 1 following the year in which the 3,500th ERU is connected will account for all of the ERUs previously connected to the DistCo system. Subsequent Refunds will be only for the incremental ERUs (i.e., those in excess of the initial 3,500) in each of the preceding calendar years. Of these amounts, and subject to Sections 3.3(e), (f) and

(g), 25% (\$1,450 per ERU) will be payable to Citizens and 75% (\$4,350 per ERU) will be payable to Developer.

c. Once at least 7,000 ERU have been connected, Refunds will retroactively increase by \$300 per ERU, and subsequent Refunds will be in the amount of \$6,100 per ERU. The payment made on the July 1 following the year in which the 7,000th ERU is connected will account for all of the ERUs previously connected to the DistCo system. Subsequent Refunds will be only for the incremental ERUs (i.e., those in excess of the initial 7,000) in each of the preceding calendar years. Of these amounts, and subject to Sections 3.3(e), (f) and (g), 25% (\$1,525 per ERU) will be payable to Citizens and 75% (\$4,575 per ERU) will be payable to Developer.

d. Once a total of 10,000 ERU have been connected within the Project, true-up payments will be made (i) to Developer for unrefunded Developer's Advances and (ii) to Citizens for unrefunded Citizens' Advances. For additional ERUs in excess of the first 10,000, Refunds will continue to be made after the true-up payment at the annual rates set forth in paragraph (c) above, subject to the limitations set forth in paragraph 2 below.

e. At Build-Out, a final true-up payment will be made (i) to Developer for the remaining unrefunded Developer's

Advances and (ii) to Citizens for the remaining unrefunded Citizens' Advances.

f. Any Refunds not made by July 1 of any year will bear interest from July 1 of that year at the Prime Rate plus 2.00% per annum until paid.

2. The total amount of all Refunds to be made to Developer will not exceed the total amount of Developer's Advances (plus any applicable interest under paragraph 1(f) above, which interest is not to be construed as part of the Refund), less payments made to Developer by TreatCo under Section 8.12(b). The total amount of all Refunds to be made to Citizens will not exceed the total amount of Citizens' Advances (plus any applicable interest under paragraph 1(f) above, which interest is not to be construed as part of the Refund), less payments made to TreatCo by Developer under Section 8.13(b). Dividends declared or paid by TreatCo to a shareholder of TreatCo do not constitute Refunds.