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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF RIO RICO UTILITIES, INC, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS WATER AND WASTEWATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO. WS-02676A-09-0257

Rio Rico Properties, Inc.'s Closing Brief

April 19, 2010

Arizona Corporation Commission
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I. **Introduction**.

Hook-up fees (HUF) are designed to collect funds for off-site utility infrastructure. The Commission faces difficult and important HUF issues in this case:

- Should a HUF be approved?
- Does Rio Rico Utilities, Inc. (Utility) have excess capacity, so that a HUF is not needed?
- If a HUF is needed, what should be the amount of the HUF?
- Should Rio Rico Utilities, Inc. (Utility) be allowed to "double-dip" by collecting additional off-site Contributions in aid of Construction (CIAC) on top of its HUF?
- Should the HUF apply to subdivisions that have pre-existing: (1) main extension agreements; (2) service provided by the Utility; or (3) accepted on-site facilities?

Rio Rico Properties, Inc. ("RR Properties") does not take a position on the first three questions.

RR Properties does not believe that the Utility should be able to "double-dip" by collecting CIAC from multiple methods. Allowing double-dipping eliminates some of the advantages of HUFs (e.g. certainty, simplicity), turns the specific HUF amount into a meaningless number, sets the stage for future conflicts, and leaves the Commission powerless to regulate the actual amount of CIAC collected. In addition, the HUF should not apply to subdivisions where: (1) there is a pre-existing main extension agreement; (2) there is pre-existing service being provided by the Utility; or (3) where the Utility has accepted on-site facilities. In those situations, HUF fees are not reasonable because the Utility already had a chance to collect CIAC for off-site facilities, and in some cases may have actually collected CIAC for off-site facilities, and should already have sufficient off-site facilities to serve the subdivision. RR Properties also requests that, if a HUF is approved, its proposed form of HUF be adopted to clarify the provisions of the HUF.

II. **Overview of HUFs.**

Like most regulatory tools, HUFs have both advantages and disadvantages. The advantages are considerable. RR Properties witness Mr. Rowell explained that a HUF "allows for … developers to fund a portion of necessary new capacity, and it does so in a way that is clear, that is straightforward, and that is predictable to both the utility and the developer."[1]

But there are dangers as well. Mr. Rowell and the Utility's witness, Mr. Sorensen, agree that excessive reliance on HUFs can result in financially weak utilities.[2] That is because the utility ends up with little or no rate base. Therefore, as the Commission has noted, excessive reliance on HUFs can have "devastating long-term consequences when the source of contributed capital no longer exists and customers alone are left to support a utility with minimal equity investment in its infrastructure."[3] In addition, the amount of a HUF can influence where developers choose to build.[4] Thus, excessive HUFs may drive developers out of a utility's service area, denying the utility additional revenues as well as increased economies of scale.

In sum, HUFs provide important benefits but can also pose significant dangers. As the Commission recently stated, there is an "inherent tension that exists between the policy of requiring growth to fund growth and assuring that there is sufficient equity investment for sustainable financial viability."[5] RR Properties takes no position on whether a HUF should be approved in this case. But if a HUF is approved, the Commission should ensure that the benefits of a HUF are realized, including certainty and predictability for all interested parties. This is the reason that RR Properties seeks approval of its proposed revisions to the HUF tariff.

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III. <u>The Commission should consider the Utility's capital structure.</u>

Utility witness Sorensen testified that he believes "the developer should pay the entire cost of off-site facilities", with some being CIAC and some being AIAC.[6] Mr. Sorensen's position is problematic because: (1) it aggravates Utility's lopsided capital structure; (2) it allows Utility to "double-dip," rendering the HUF amount and terms meaningless, because the utility remains able to impose off-site facility charges above and beyond the HUF; (3) it allows the Utility to impose HUFs on properties where off-site funding was or should have been collected in the past; and (4) it

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[1] Tr. at 563:19-23.
[2] Ex. I-3 (Rowell Direct) at 3:10-14; Tr. (Sorensen) at 621:23 to 622:1 and 638:5-9.
[3] Decision No. 71414 (December 8, 2009) at 9.
[4] Tr. at 636:15-24.
[5] Decision No. 71414 (December 8, 2009) at 9.
[6] Tr. 640:15-19.

enables the Utility to extract money from landowners, even when the Utility has excess capacity in its current off-site facilities.

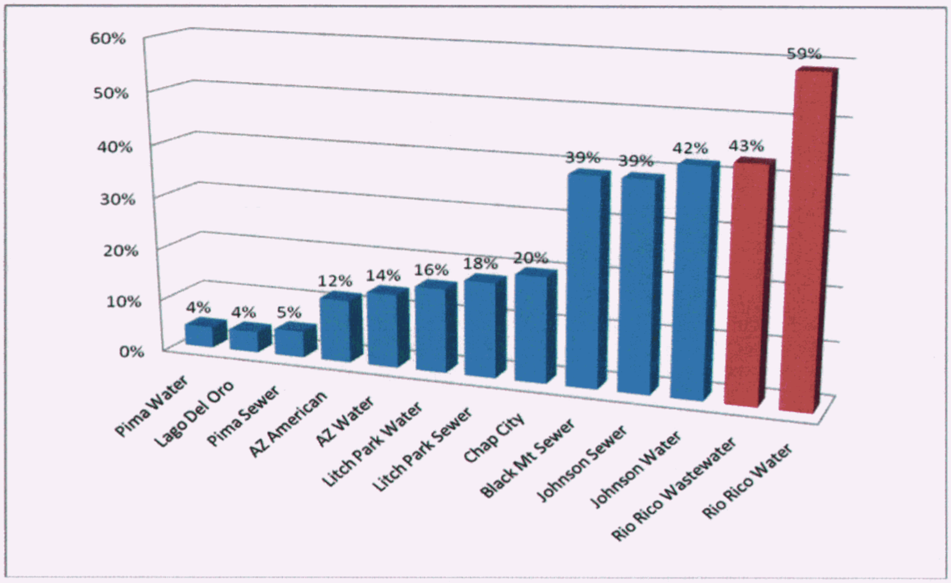
A. Utility's capital structure is unbalanced.

Despite the Utility's professed intent to "balance" its capital structure, its capital structure is unbalanced with a significant amount of CIAC – yet Utility seeks ever more funds from landowners. Currently, CIAC is 67% of Utility's capital structure.[7] That is more than double the amount of equity in its capital structure.[8] In comparison, Staff typically recommends that CIAC <u>and</u> AIAC constitute no more than 30 percent of a company's total capitalization.[9]

As shown on Exhibit I-5, Utility has more CIAC as a percentage of gross plant than comparable Arizona utilities:

I-5

Figure 1: CIAC as a percentage of gross plant for selected AZ utilities



Thus, the Utility has significantly more CIAC as compared to Staff's typical benchmark, or as compared to similar Arizona utilities.

[7] Ex. I-4 (Rowell Surrebuttal) at 2:18.
[8] Ex. I-4 (Rowell Surrebuttal) at 2:21-23.
[9] Decision No. 71414 (December 8, 2009) at 9; Ex. I-4 (Rowell Surrebuttal) at 3:5-6.

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Mr. Sorensen testified that his proposals are necessary to "balance" Utility's capital structure[10], speaking of the "balancing act we have to do to avoid using 100 percent investor supplied capital."[11] RR Properties agrees that utility investors should not have to pay for 100% of new off-site facilities. There is no danger of that. But the Utility apparently seeks to have landowners pay 100% of those costs. That is not appropriate either. The Utility should have some investment in its new facilities. After all, the Utility benefits from growth, as Mr. Sorensen conceded.[12] Moreover, CIAC is not the only alternative to common equity. Debt and preferred stock can also finance part of the cost of off-site facilities. Notably, Utility has no debt and no preferred stock.[13] Moreover, Mr. Sorensen stated that Utility's request for a HUF is not "justified, in whole or in part, by RRUI's inability to raise capital."[14] Thus, Utility has not shown that it needs landowners to pay for 100% of the cost of Utility's off-site facilities.

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B. The Commission should not allow "double-dipping" by the Utility.

A key benefit of a HUF is that it provides certainty to all parties regarding the amount per hook-up that the landowner will pay for off-site utility facilities. This is simpler than attempting to craft unique amounts for each property, and it also eliminates the potential for disagreements and even litigation over the amounts. But these HUF benefits will not be realized if the Utility is allowed to require additional CIAC or AIAC fees for off-site facilities on top of the HUF (i.e. "double dipping"). In other words, the HUF should be the only money collected by the Utility for off-site utility infrastructure. Otherwise, there is no purpose in setting a specific HUF amount in a tariff. Thus, the Commission should set the HUF at the level that is sufficient to collect whatever the Commission believes is the appropriate amount for off-site facilities, and the Commission should not allow Utility to collect any CIAC for off-site facilities over and above the HUF.

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[10] Ex. A-3 (Sorensen Rejoinder) at 12:8-24.
[11] Ex. A-3 (Sorensen Rejoinder) at 13:6-10.
[12] Tr. 636:11-14.
[13] Tr. (Sorensen) at 643:2-6.
[14] Ex. I-1 (Utility responses to data requests) at Response 2.12.

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C. Property where the HUF should not apply.

Some properties that should be "grandfathered in" – the HUF should not apply to those properties. Because there are many steps to the development process, in some cases, provisions have already been made for off-site facilities. HUFs are intended to pay for off-site facilities, so the HUF should not apply to those properties. It appears that the parties agree with this general principle, but disagree as to which properties should be grandfathered.

Some properties are covered by existing main extension agreements. Because no HUF is currently in place, current main extension agreements include requirements for landowners to pay for off-site facilities as necessary and appropriate. Mr. Rowell testified that these properties should not have to pay for off-site facilities a second time, so the HUF should not apply to those properties.[15] Mr. Sorensen agreed.[16]

Likewise, the HUF should not apply to subdivisions where the Utility is already providing service, or where the Utility has accepted "on-site" facilities.[17] Utilities typically require main extension agreements prior to those events occurring. Thus, if there is no main extension agreement for such properties, the utility would have determined that no additional off-site facilities were necessary prior to service. Because the HUF is based on off-site facilities, including water production or wastewater treatment capacity, the HUF should not apply in those situations. Moreover, a utility should not provide service or accept on-sites without sufficient off-site capacity.[18]

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[15] Ex. I-4 (Rowell Direct) at 8:1-4.
[16] Ex. I-1 (Utility responses to data requests) at Response 2.22.
[17] Ex. I-3 (Rowell Direct) at 6-7.
[18] See e.g. A.A.C. R14-2-406(B)(1)("In the event that additional [off-site]facilities are required" they may be included in the main extension agreement); R14-2-407(A)(utility "responsible for providing potable water to the customer's point of delivery"); R14-2-407(E)(utility must provide minimum pressure of 20 psi at customer's point of delivery).

D. The Commission should not allow Utility to collect additional CIAC for off-sites if the HUF is denied.

Staff found that Utility has adequate capacity "to serve its existing customer base reasonable growth for the foreseeable future."[19] Utility disagrees. RR Properties takes no position in that dispute. However, if the Commission agrees with Staff on this point, and denies the HUF, then the Utility should not be allowed to collect additional funds from developers to pay for off-site facilities. If the Utility in fact has sufficient capacity for existing customers and growth, then additional off-site facilities are not needed. The Utility should not be able to extract funds from landowners to pay for unneeded facilities. Moreover, allowing the Utility to collect additional funds in those circumstances would amount to evading the Commission's ruling denying HUFs and finding adequate capacity (if it, in fact, so rules). The prohibition should apply until the Commission approves a HUF or finds that additional off-site capacity is needed.[20]

IV. HUF Conditions.

If the Commission decides to approve a HUF, it should adopt the form of tariff proposed by RR Properties. As Mr. Rowell explained, "the language contained in a utility's HUF is extremely important."[21] Clear tariff language is vital to providing all parties with clarity and certainty and for preventing future disputes.

As Mr. Rowell explained, some of the Utility's proposed tariff language is unclear, or creates uncertainty by possibly allowing the utility an open-ended right to demand future payments. For example, the Utility's proposed tariff speaks of an undefined "supplemental assessment" that "may" apply.[22] Likewise, the tariff refers to "additional facilities required by the Company" and "additional requirements imposed by the Company" without limiting what those facilities or requirements may be, or when the utility may impose them.[23] The Commission should

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[19] Ex. S-9 (Liu Surrebuttal) at 4:1-4 (water) and 4:12-13 (wastewater).
[20] Ex. I-4 (Rowell Surrebuttal) at 11:17-19.
[21] Ex. I-4 (Rowell Surrebuttal) at 8:22-23
[22] Id. at 6:27 to 7:3.
[23] Id. at 7:5-12.

not hand the Utility a blank check to fill in as it pleases. Indeed, all of these provisions are not found in the Commission's standard form of HUF tariff.

Should the Commission determine that a HUF is appropriate, RR Properties has provided a proposed form of tariff that is based on the Commission's standard form of HUF tariff with appropriate additional language to address and clarify the issues at dispute in this docket.[24]

V. **Conclusion.**

RR Properties agrees that it should pay its fair share of the costs for off-site facilities. But the Utility also benefits from growth. Moreover, excessive reliance on HUFs leads to financially enfeebled utilities. Utility greatly exceeds Staff's CIAC target, and it has relatively more CIAC than all of its peer utilities. Thus, the Utility should also invest something in the off-site facilities. That investment can be done through common equity, preferred equity, or debt.

In addition, a clear HUF is very important to RR Properties. Ambiguous terms invite the Utility to "interpret" them to its maximum advantage. And uncertainty clouds developers' planning, budgeting and investing decisions. If the Commission decides a HUF is appropriate, it should ensure the HUF will be clear, straightforward to administer, and provide cost certainty to landowners. Thus, the Commission should not allow the Utility to pile additional charges on top of the HUF; and the Commission should approve RR Properties' proposed form of tariff.[25] The Utility's proposed HUF tariff oversteps the purpose and key policy parameters for HUFs and it should be rejected.

Lastly, the Commission should not allow Utility to collect funds for off-sites when additional off-sites are not needed. Thus the Utility should not be allowed to collect CIAC or AIAC for off-sites if the HUF is denied, and if the HUF is approved, it should not apply to properties where:

- An existing main extension agreement is in place;
- The Utility is already providing service; or

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[24] Attachments 1 and 2 to Ex. I-4 (Rowell Surrebuttal).
[25] Attachments 1 and 2 to Ex. I-4 (Rowell Surrebuttal).

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- The Utility has accepted off-sites.

RESPECTFULLY SUBMITTED this 19th day of April 2010.

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