

OPEN MEETING AGENDA ITEM

EXCEPTION



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BEFORE THE ARIZONA CORPORATION COMMISSION

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2010 AUG -4 P 4: 02

AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF
GLOBAL WATER - PALO VERDE UTILITIES
COMPANY FOR THE ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES FOR UTILITY
SERVICE DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE OF ITS
PROPERTY THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. SW-20445A-09-0077

IN THE MATTER OF THE APPLICATION OF
VALENCIA WATER COMPANY - GREATER
BUCKEYE DIVISION FOR THE ESTABLISHMENT OF
JUST AND REASONABLE RATES AND CHARGES FOR
UTILITY SERVICE DESIGNED TO REALIZE A
REASONABLE RATE OF RETURN ON THE FAIR
VALUE OF ITS PROPERTY THROUGHOUT THE
STATE OF ARIZONA

DOCKET NO. W-02451A-09-0078

IN THE MATTER OF THE APPLICATION OF
WILLOW VALLEY WATER CO. FOR THE
ESTABLISHMENT OF JUST AND REASONABLE
RATES AND CHARGES FOR UTILITY SERVICE
DESIGNED TO REALIZE A REASONABLE RATE OF
RETURN ON THE FAIR VALUE OF ITS PROPERTY
THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. W-01732A-09-0079

IN THE MATTER OF THE APPLICATION OF
GLOBAL WATER - SANTA CRUZ WATER COMPANY
FOR THE ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES FOR UTILITY
SERVICE DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE OF ITS
PROPERTY THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. W-20446A-09-0080

IN THE MATTER OF THE APPLICATION OF
WATER UTILITY OF GREATER TONOPAH FOR
THE ESTABLISHMENT OF JUST AND REASONABLE
RATES AND CHARGES FOR UTILITY SERVICE
DESIGNED TO REALIZE A REASONABLE RATE OF
RETURN ON THE FAIR VALUE OF ITS PROPERTY
THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. W-02450A-09-0081

Global Utilities' Exceptions

Arizona Corporation Commission
DOCKETED

AUG 4 2010

DOCKETED BY

1 IN THE MATTER OF THE APPLICATION OF
2 VALENCIA WATER COMPANY – TOWN DIVISION
3 FOR THE ESTABLISHMENT OF JUST AND
4 REASONABLE RATES AND CHARGES FOR UTILITY
5 SERVICE DESIGNED TO REALIZE A REASONABLE
6 RATE OF RETURN ON THE FAIR VALUE OF ITS
7 PROPERTY THROUGHOUT THE STATE OF ARIZONA

DOCKET NO. W-01212A-09-0082

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Global Utilities' Exceptions

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1 **I. Introduction.**

2 Global appreciates the detailed and thoughtful analysis in the Recommended Opinion and
3 Order (ROO).¹ And Global applauds the professionalism and cooperation shown by Staff and
4 RUCO in this proceeding. As a result, this case does not have many of the usual rate case
5 disputes. In fact, as a result of the parties' cooperation and hard work there is only one critical
6 policy issue in the case – how should the Commission treat revenues received by Global Parent
7 from Infrastructure Coordination and Financing Agreements (ICFAs)? Global developed ICFAs
8 as a tool to: (1) maximize water conservation and the use of recycled water; (2) engage in regional
9 planning to ensure there will be sustainable water use in the future (especially in high-growth
10 areas with scarce water); and (3) acquire and consolidate small undercapitalized utilities that are
11 incapable of building necessary water conservation facilities. ICFAs require developers to fund
12 part of the cost of these important policy goals. The ROO's proposed treatment of ICFA funds
13 effectively precludes using ICFAs to provide these public benefits – even though ICFAs have
14 been (to date) the only effective and economic way to meet the challenges of sustainable growth
15 and achieve the goals of water conservation and small utility consolidation.

16 Global believes that when ICFA funds are used for purposes other than building plant –
17 such as buying undercapitalized utilities, or covering the carrying costs of sustainable regional
18 water infrastructure, or paying the taxes on ICFA revenue – then ICFA funds should not be treated
19 as Contributions In Aid of Construction (CIAC or contributions).

20 However, the ROO treats *all* ICFA revenues as contributions – every single dollar of ICFA
21 funds received by Global Parent is treated as CIAC without considering the use of the funds. The
22 ROO justifies this by stating that “[a]llowing developer contributed funds to remain in rate base...
23 violate[s] fundamental ratemaking principles.”² Global agrees that developer-contributed funds
24 that were used to pay for utility plant should be excluded from rate base. But ICFA funds that

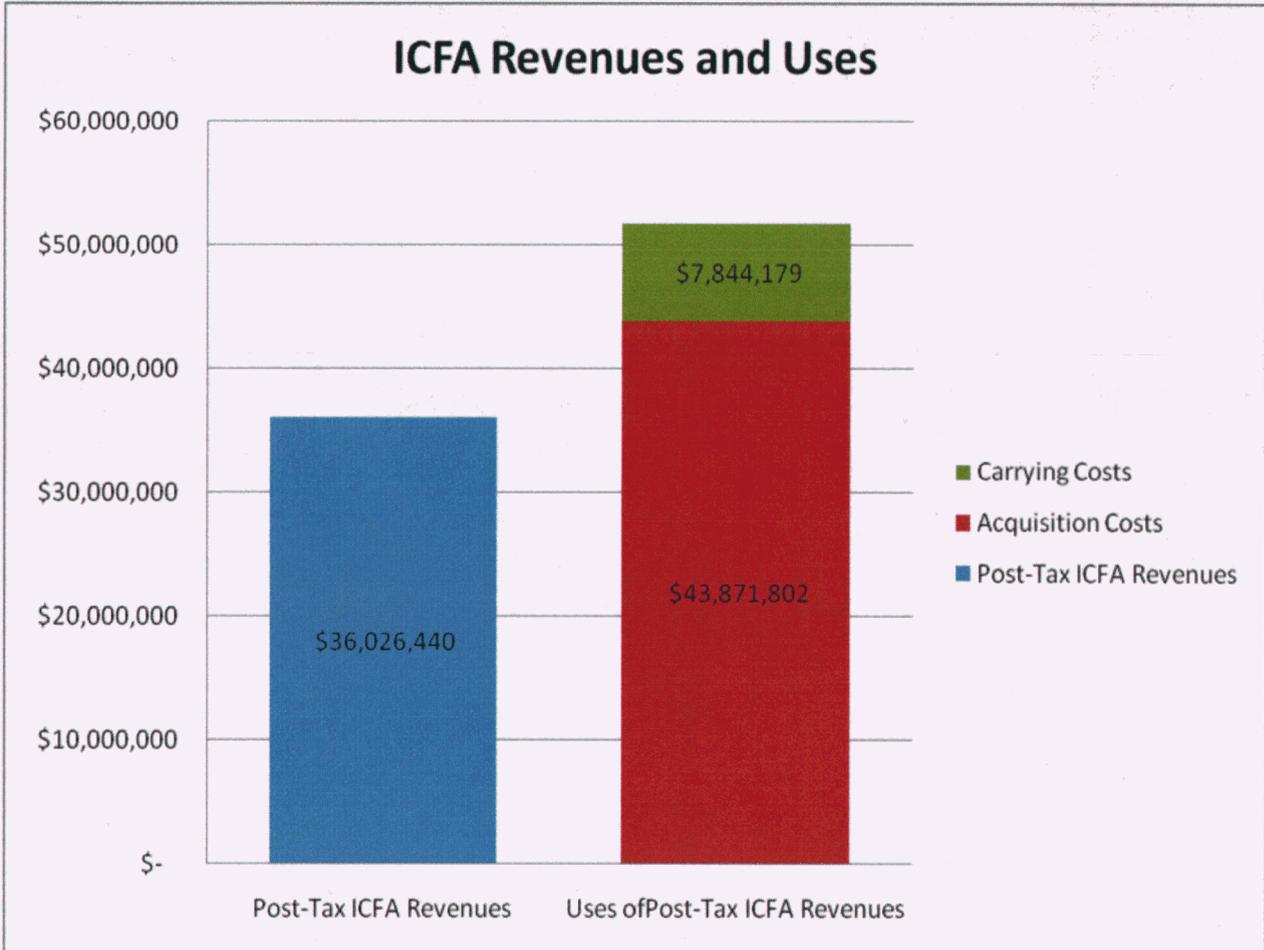
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27 ¹ Unless otherwise defined in these Exceptions, all defined terms have the meanings set forth in
the Glossary to Global's Closing Brief.

² ROO at 30:5-7.

1 were not used for utility plant should not be used to reduce rate base. The record shows that ICFA
2 funds were not used for construction of utility plant:

- 3 (1) Over \$43.8 million of the ICFA funds were used to consolidate numerous
4 undercapitalized utilities directly in the path of the rapid development. This
5 amount was paid to the sellers, and thus was not invested in plant.
- 6 (2) Global used ICFA funds to pay over \$7.8 million in interest payments on IDA
7 bonds in 2007 and 2008. That money could not have been used to build plant.
- 8 (3) The ICFA funds generated \$24 million in tax liability – money that ends up in the
9 government’s bank account cannot be used to pay for plant.

10 The use of ICFA funds received by Global Parent is shown on the following chart:³



27 ³ Sources: Total ICFA Funds: Ex. A-13 (Rowell Rebuttal) at 13; Tax Liability of ICFA Funds: Id.; Acquisition Costs: Id. at 24; Carrying Costs: Id. at 23

1 Treating all ICFA funds as contributions also creates an enormous problem for Water
2 Utility of Greater Tonopah (WUGT) – it creates a negative rate base of \$4.1 million. So if Global
3 invests \$1 million, or \$4 million in WUGT, it will earn no return of or on that investment. In
4 addition, the \$2.6 million invested in WUGT since Global’s acquisition of that undercapitalized
5 utility would be lost. The negative rate base essentially turns WUGT into an investment black
6 hole. Worse still, WUGT is located in the Lower Hassayampa sub-basin which has been the
7 center of concern by ADWR, ADEQ, Maricopa County, and the City of Buckeye because of its
8 documented over-allocated groundwater supplies. A negative rate base in WUGT hamstrings any
9 efforts to invest for the future or upgrade existing facilities.

10 Global understands the financial crisis has caused hardship to many of its customers – all
11 parties in this case agree that the rates should be kept as low as possible so as to minimize the
12 impact on customers. Global reacted to the economic downturn by cutting costs severely –
13 including eliminating 40% of its employees⁴ and only allowing 16% (\$162,428)⁵ of executive pay
14 to be allocated to the regulated utilities – thus reducing expenses to be recovered in this case.
15 Global also voluntarily removed \$32 million of unused plant from rate base. And Global
16 proposed a Low Income Relief Tariff and an innovative Demand Side Management program to
17 help customers reduce their bills. Further, Global stipulated to Staff’s cost of equity, and included
18 a number of concessions in its application and during the course of this proceeding that directly
19 reduce costs to consumers, including:

- 20 (1) Imputing low-cost parent-level IDA debt;
- 21 (2) Excluding \$32 million in plant from rate base;
- 22 (3) Voluntary phasing-in Palo Verde’s wastewater rates over three years; and
- 23 (4) Voluntarily phasing-in non-potable water rates over five years.

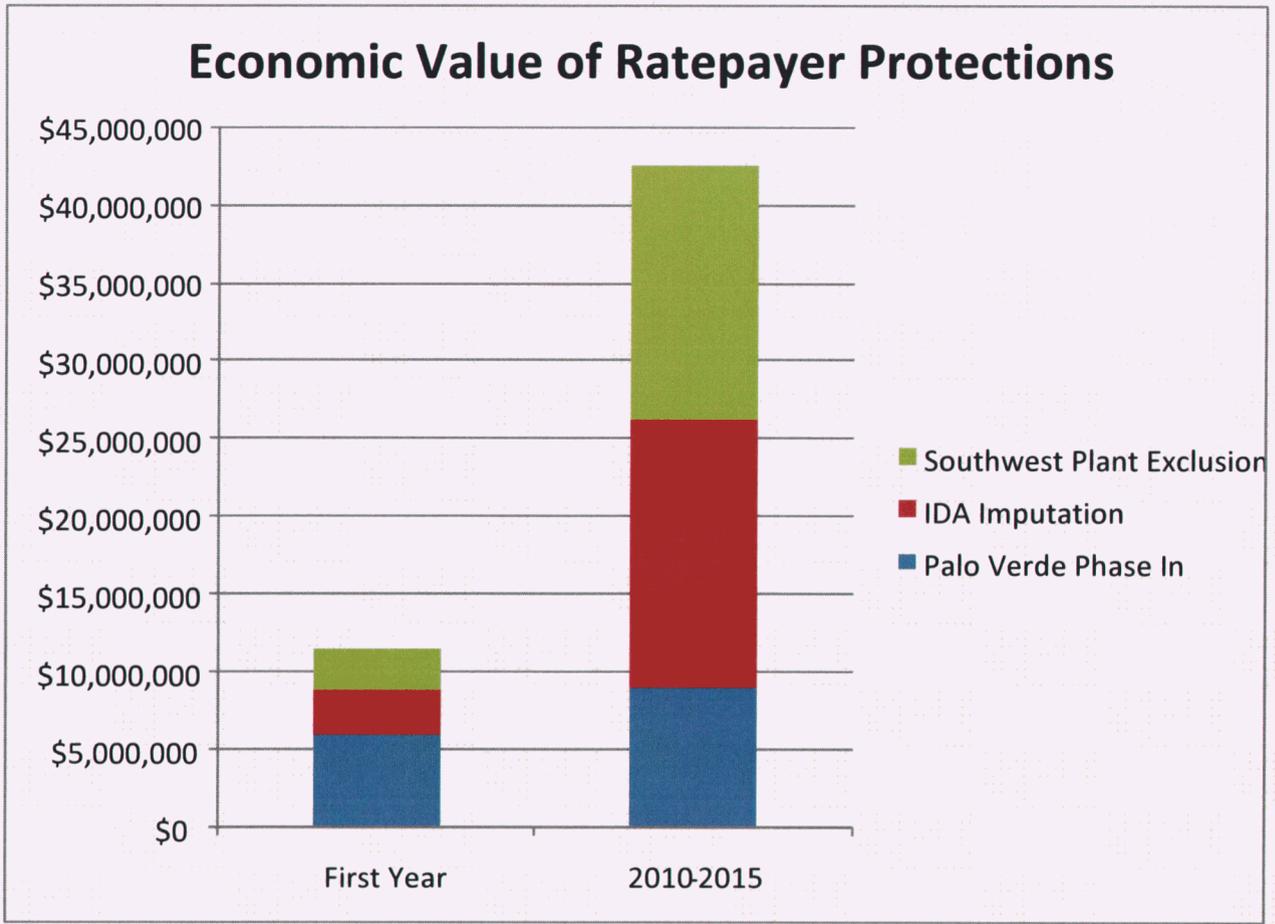
24 Unlike other rate phase-in situations, Global is not seeking any recovery of the foregone revenues.

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⁴ Tr. (Hill) at 35.

⁵ Ex. A-9 (Hill Rejoinder) at 5.

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II. ICFAs are necessary to fund the regional plant needed for Total Water Management.

A. Arizona needs Total Water Management.

Arizona is an arid state. Managing water is a significant part of Arizona’s history – the Hohokam irrigation canals, SRP & the building of the Roosevelt Dam, the Hoover Dam, the *Arizona v. California* Supreme Court cases, the decades of political leadership that led to the CAP canal. As Arizona faces renewed growth after the current downturn ends, and as the over-allocated Colorado River becomes more variable, water issues will undoubtedly play an important part in Arizona’s future. A recent National Academy of Sciences report warned:

A future of increasing population growth and urban water demands in a hydroclimatic setting of limited – and likely decreasing – water supplies presents **a sobering prospect for elected officials and water managers**. If the region’s water resources are to be managed sustainably and to continue to provide a broad

1 range of benefits to an increasing number of users, the realities of Colorado River
2 water demand and supply will have to be addressed openly and candidly.⁶

3 Global was founded with a vision for “Total Water Management” (TWM). A recent book
4 published by the American Water Works Association defines TWM as “stewardship and
5 management of water on a sustainable use basis.”⁷ Global CEO Trevor Hill defined TWM as
6 “...in a word it's sustainability.... And what that entails is using the right water for the right use,
7 which is heavily reliant on the use of recycled water in emerging communities.”⁸ The concept of
8 “the right water for the right use” means not using expensive and scarce potable water for non-
9 potable uses, like landscape irrigation. Thus, the cornerstone of Global’s plan is using recycled
10 water (highly treated effluent) for reuse (purple pipe irrigation) and recharge (into the aquifer).

11 TWM is urgently needed – now. When growth returns, it will be in two major areas:
12 western Maricopa County, and Pinal County. Global has a big presence in both these areas. And
13 both these areas face significant water issues. In Pinal County, ADWR projects municipal
14 groundwater demands of 120,000 acre-feet per year, greatly exceeding ADWR’s estimated
15 renewable groundwater supply of 82,500 acre-feet per year.⁹ In western Maricopa County (Lower
16 Hassayampa Sub-basin), according to ADWR, “there is insufficient groundwater... without
17 integrated water, wastewater and recycled water, long-term planning, and a holistic approach to
18 water supply. There is simply not enough water.”¹⁰

19 Global’s TWM philosophy has already achieved results. In Maricopa, the Global Utilities
20 use 40% less groundwater through recycled water reuse.¹¹ This saved two billion (2,000,000,000)
21 gallons of groundwater through the end of 2009.¹²

22 ⁶ National Research Council, “Colorado River Basin Water Management: Evaluating and
23 Adjusting to Hydroclimatic Variability” (National Academy of Sciences 2007) at 72 (emphasis
24 added), quoted in Ex. A-8 (Hill Rebuttal) at 6.

25 ⁷ N. Grigg, “Total Water Management: Practices for a Sustainable Future” (American Water
26 Works Association 2008) at Page 1, quoted in Ex. A-8 (Hill Rebuttal) at 4.

27 ⁸ Tr. (Hill) at 193.

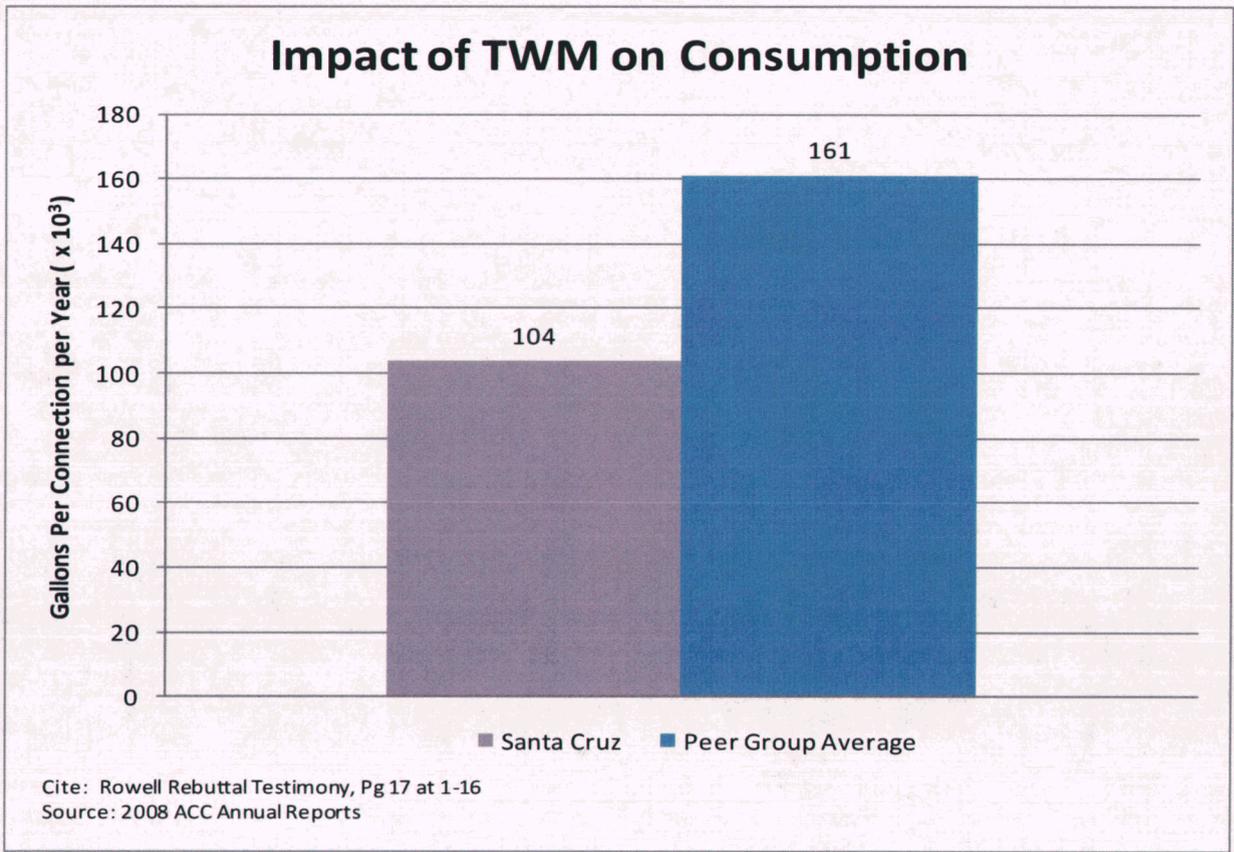
⁹ ADWR, Pinal AMA “Assured Water Supply Rules Modification Concepts”, Final Subcommittee
Draft, Approved by Pinal AMA Groundwater Users Advisory Council, 23 Feb. 2006.

¹⁰ Letter dated Nov. 16, 2009 by Karen Smith, Deputy Director ADWR, filed in Docket No. SW-
20422A-06-0566.

¹¹ Tr. (Hill) at 194 to 195.

¹² Ex. A-32.

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Unfortunately, the Global Utilities are the only utilities in Arizona implementing TWM.¹³ That is not because other water utilities are irresponsible or do not care about sustainability. It is because TWM cannot be pursued under traditional ratemaking methods. This is because effective and economical reuse requires regional facilities to achieve economies of scope and scale. And regional facilities require regional planning, and careful design and timing of construction projects.¹⁴

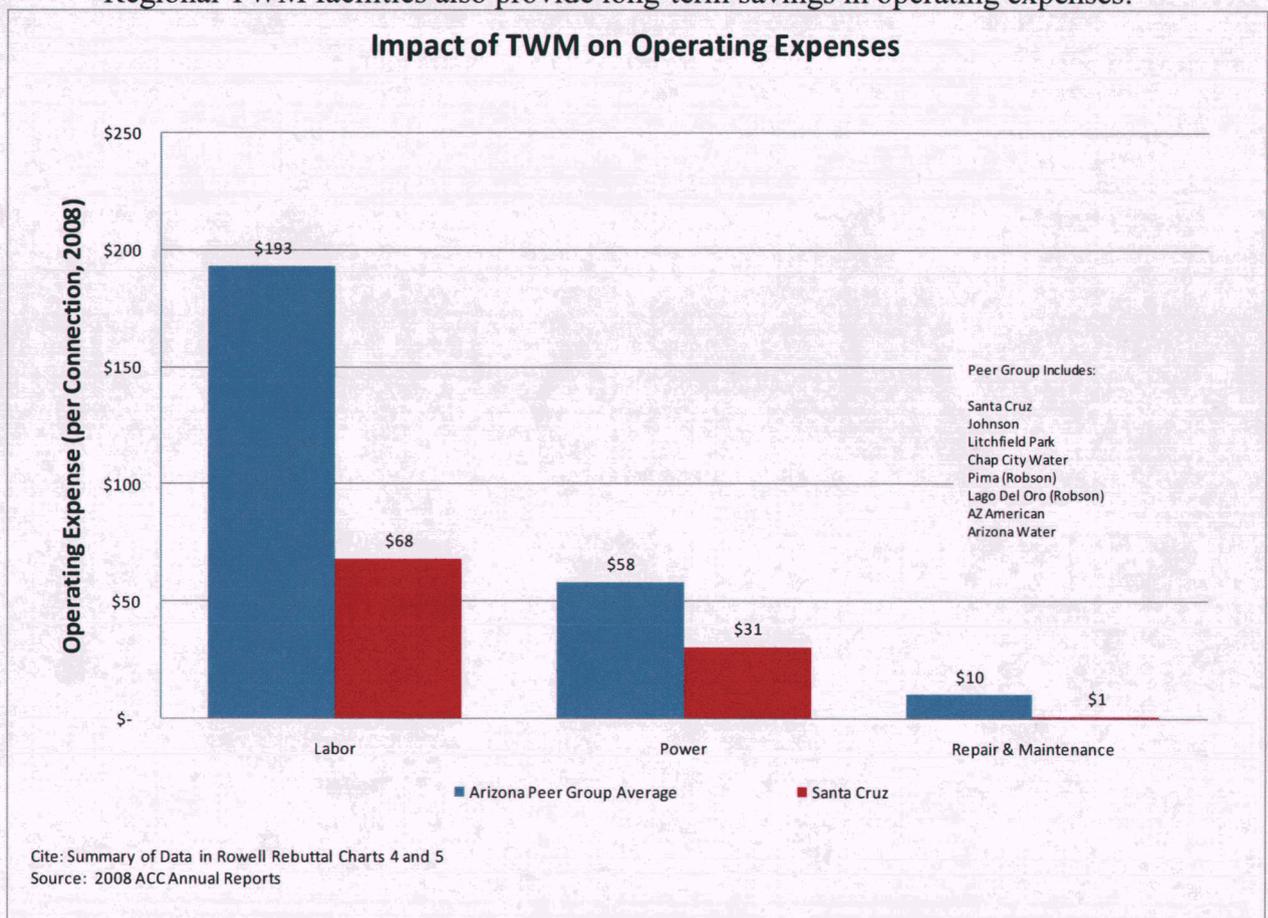
Regional facilities cannot be achieved by building separate facilities or increments of plant for each developer. Without regional facilities based on a regional plan, growth results in a haphazard jumble of infrastructure, including multiple small mains running down the same street to serve different developments, numerous small diameter wells, and multiple lift-stations – one for each development. This is not just conjecture (see Johnson Utilities); it has happened and will

¹³ Tr. (Rigsby) at 641.
¹⁴ Ex. A-24 (Symmonds Direct) at 7 to 21.

1 continue to happen in high growth areas. And ratepayers and the environment pay the price – now
2 and into the future.

3 Ultimately, if regional facilities are built, there will be some excess capacity until
4 customers “fill in”. Utilities must have some means of dealing with the carrying costs of this
5 excess capacity until the plant is in service. As Staff’s witness Ms. Jaress explained, “[a]s it
6 relates to utility plant, carrying cost is the cost of capital during the time – during the construction
7 process through the time where the company starts earning a return on it.”¹⁵ Allocating ICFA
8 funds to carrying costs allows Global to (partially) offset the substantial carrying costs of plant not
9 yet deemed to be “used and useful”. Rational utilities will not spend money in unrecoverable
10 carrying costs to build TWM-based plant. So it is no surprise that, other than Global, Arizona
11 utilities have not done so.

12 Regional TWM facilities also provide long-term savings in operating expenses:



¹⁵ Tr. (Jaress) at 865.

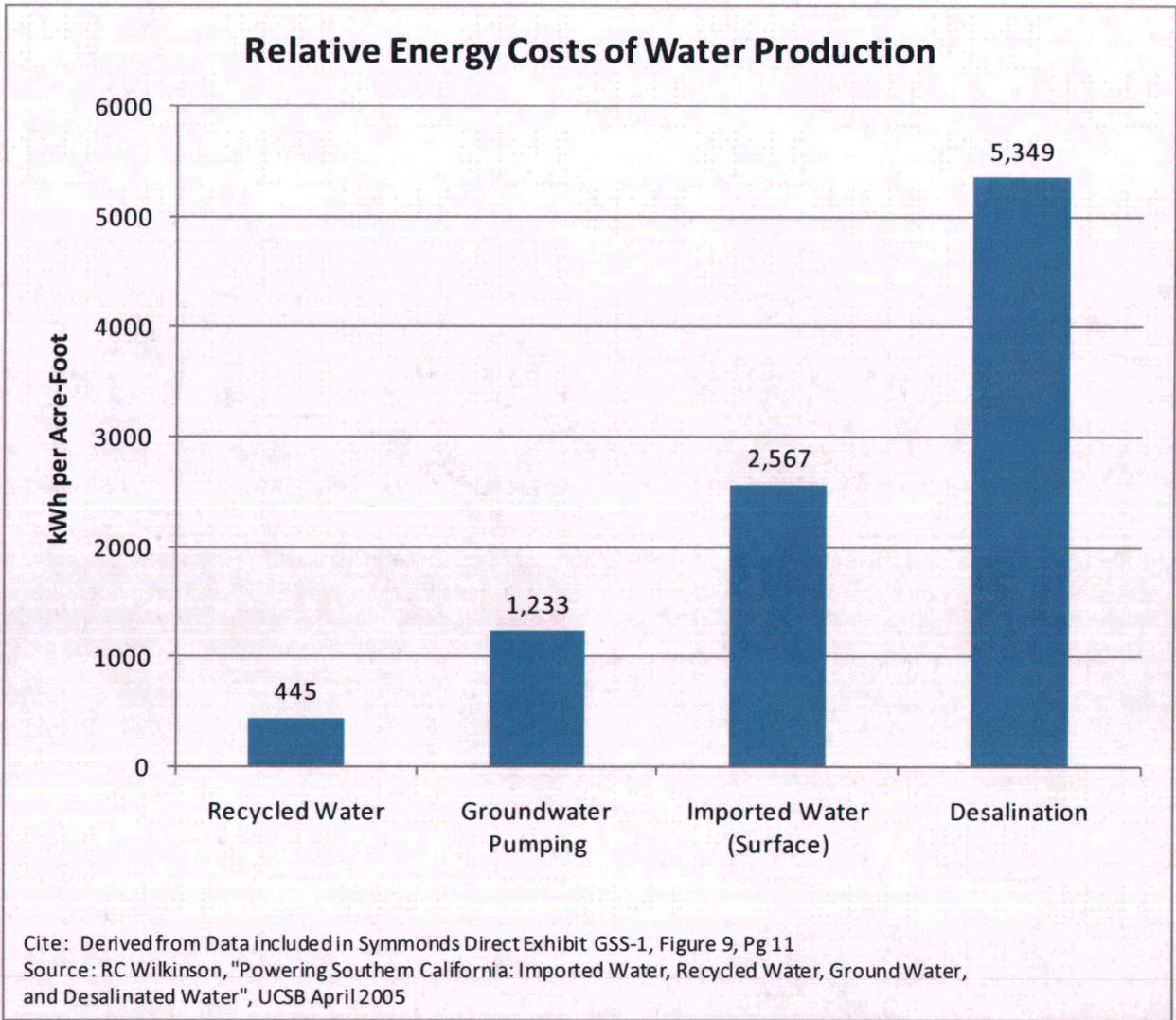
1 Johnson Utilities provides a good comparison. Indeed, in this rate case, it was Staff that
2 put forward Johnson Utilities as an example of a new utility that made appropriate use of
3 contributions.¹⁶ Global agrees with Staff that a comparison with Johnson Utilities is appropriate
4 because Johnson Utilities is a large, new utility in Pinal County, as are Global's two largest
5 utilities, Santa Cruz and Palo Verde. However, as Mr. Hill testified, Johnson Utilities is a classic
6 example of the consequences of over-reliance on contributions – an “uneconomical utility to
7 operate” with undersized, inefficient facilities and “basically no rate base.”¹⁷ Furthermore,
8 Johnson's operating costs per customer are by far the highest of any of its peers.¹⁸ There is a stark
9 difference between the Johnson Utilities model and Global's model – the Commission must make
10 a policy choice, whether to allow Global's model of using ICFA funds to offset the carrying costs
11 of regional plant or to accept the unsustainable status quo as the future paradigm for water and
12 wastewater utilities in Arizona.

13 The Commission has become increasingly aware of the “energy / water nexus” – the fact
14 that energy decisions often have significant water impacts, and water decisions often have
15 significant energy impacts. Water is heavy – it takes a lot of power to pump it up from the aquifer,
16 and it takes a lot of power to move it from surface water sources like the Colorado River.
17 Recycled water is an extremely energy efficient source of water, because it is already on the
18 surface and located in the area where it will be used. Mr. Hill and Mr. Symmonds demonstrated
19 this in a study they prepared, “The Energy and Water Efficiency Benefits of Distributed Recycled
20 Water Production Facilities.”¹⁹ The differences in power use are large:

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26 ¹⁶ Ex. S-11 (Jaress Surrebuttal) at 14:1-10.
27 ¹⁷ Tr. (Hill) at 77-78; 141:18-22; 215-216.
¹⁸ Ex. A-13 (Rowell Rebuttal) at 18, Chart 3 (water operating costs).
¹⁹ Ex. A-24 (Symonds Direct) at Attachment GSS-1.

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Regional planning, leading to regional plant, was how the Global Utilities saved two billion gallons of groundwater in Pinal County. But this regional approach creates risks. The risk is that regional plant, designed for efficiency and economies of scale, will not be considered fully “used and useful”. That puts some or all of Global’s investment in plant at risk. This is where the ICFA agreements come into play – the ICFA funds help Global cover the carrying costs of the plant until it is used and useful; at the same time they shield ratepayers from having to pay the carrying costs of that unused plant, and once the plant is in service, ratepayers benefit from the lower operating costs of efficient regional plant.

1 ICFAs also remove developers from control over utility plant design. Developers will not
2 own or operate the plant, so they have no incentive to design sustainable regional plant with low
3 operating expenses – instead, they seek the lowest up-front capital costs.²⁰

4 **B. Example – the “Southwest Plant” in Pinal County.**

5 The potential short-term risks of building regional plant are exemplified by the
6 “Southwest” plant Global constructed south of Maricopa. The Commission ordered Global to
7 build this plant,²¹ and there was every indication it would be needed, as Mr. Hill explained:

8 Clearly there are reasons to build the plant. This is a regional area; many final
9 plats were occurring in the area. If you look at it, you'll see roads and sidewalks,
10 and there was every indication this was going to be an area full of homes.²²

11 So Global built the plant, but development stopped midstream, and now the plant is mothballed,
12 sitting unused amidst hundreds of acres of empty lots. The plant cost \$32 million.²³ A majority
13 of the plant was paid for with IDA bonds (\$26.8 million) that are specifically tied to the plant.²⁴

14 Global voluntarily excluded the \$32 million from rate base because the Southwest Plant is
15 not used and useful. The ROO takes a different approach - the ROO treats the entire \$32 million
16 as contributions, even though \$26.8 million came directly from the IDA bonds. Therefore, under
17 the ROO, the Southwest Plant will never go into rate base – even when it is fully used. This is a
18 significant problem, because Global must pay interest on the IDA bonds, but it will never earn a
19 return on the \$32 million if the ROO is approved.

20 **C. The Commission should recognize carrying costs for regional plant.**

21 Global conservatively estimated the carrying costs it incurred for regional plant not in rate
22 base as \$14,946,406.²⁵ Global used ICFA funds to partially offset these costs. Because Global
23 used the ICFA funds to offset these carrying costs, the \$14,946,406 in funds should not be treated
24 as CIAC. But to be doubly conservative, Global proposes that the amount of the carrying cost

25 ²⁰ Ex. A-24 (Symmonds Direct) at 11-16; Ex. A-7 (Hill Direct) at 33.

26 ²¹ Ex. A-12 (Rowell Direct) at 9-12, citing Decision No. 68448 (Nov. 21, 2005).

27 ²² Tr. (Hill) at 224.

²³ Ex. A-12 (Rowell Direct) at 9-11.

²⁴ Tr. (Hill) at 222-223; Ex. A-34; Ex. A-35.

²⁵ Ex. A-13 (Rowell Rebuttal) at 23.

1 allowance be limited to its interest expense for IDA bonds in 2007 and 2008: \$7,844,179.²⁶

2 These are actual interest payments Global was required to make, and did make. Because these
3 funds were paid as interest payments, they could not have been used to build plant.

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5 **III. The Commission should allow developers to help pay for consolidation of water**
6 **utilities.**

7 **A. The problem – Arizona’s multitude of utilities need consolidation.**

8 Arizona’s many small utilities are a constant source of problems. Chairman Mayes stated
9 at the most recent NARUC conference in Sacramento that she has spent a substantial amount of
10 her time as a commissioner dealing with the problem of small, troubled water companies. Some
11 fail spectacularly, causing massive Commission involvement to clean up the mess – often
12 requiring more capable companies like Global to assume the role of “interim manager.” Others
13 are time bombs waiting to go off – just one failed pump, ruptured tank or broken main away from
14 collapse and without the resources to respond to any problems. But mostly, these companies just
15 limp along; ineffectual entities lacking resources, expertise and economies of scale. Moreover,
16 even those small utilities that have professional and committed leadership lack the capacity to
17 build the regional infrastructure needed for sustainable water use and reuse.²⁷

18 This problem is large – Arizona has nearly 300 water companies.²⁸ This industry structure
19 is highly fragmented as compared to neighboring states. These states have significant private
20 water companies – for example, in California private water companies serve 20% of California’s
21 population.²⁹ But these states do not have Arizona’s massive number of water companies, as the
22 graph below shows:³⁰

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25 ²⁶ Ex. A-9 (Hill Rejoinder) at Ex. 5.

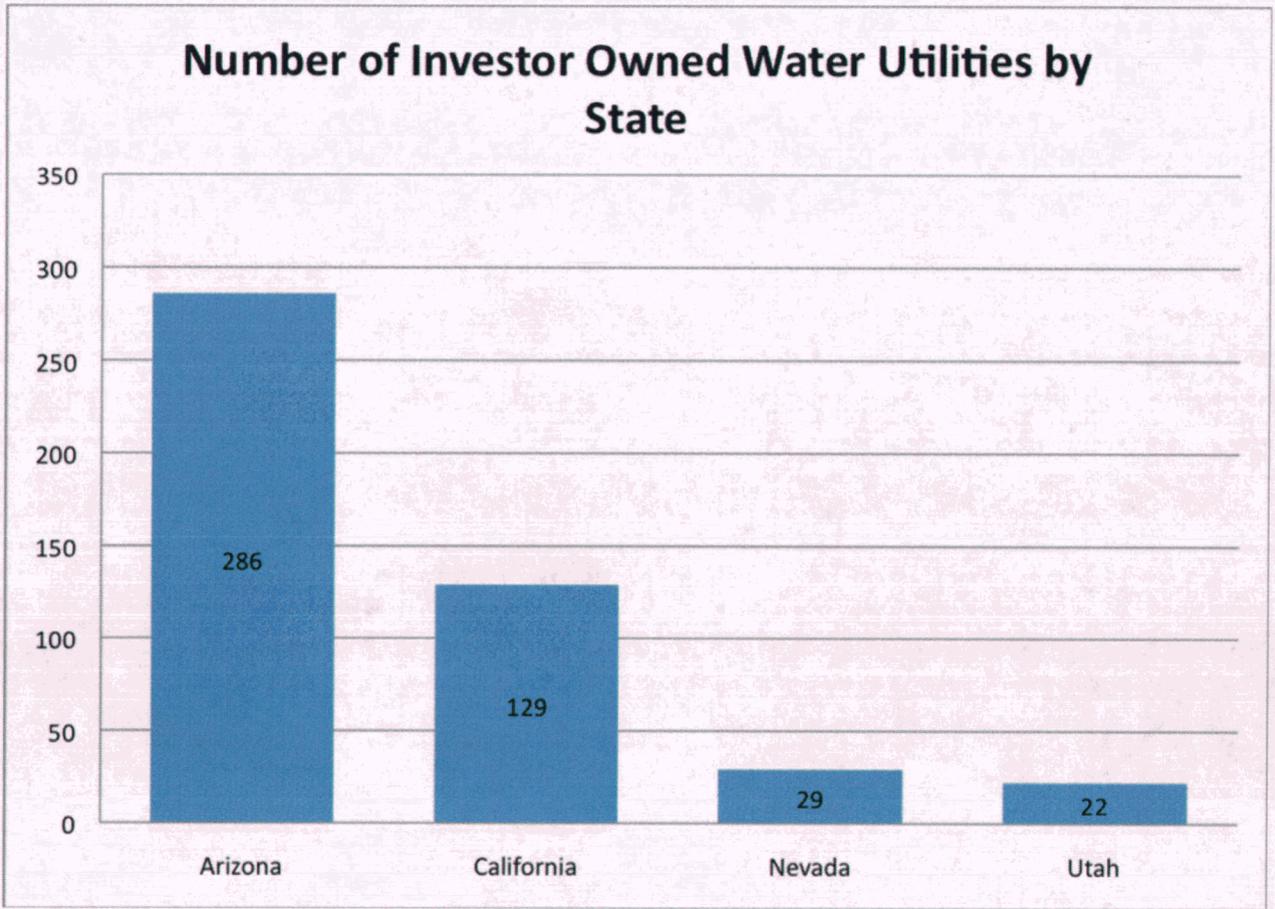
26 ²⁷ Tr. (Hill) at 102:15 to 103.11.

27 ²⁸ Ex. A-45 (Staff Responses to Data Requests) at Response to Global 2.41(b)(v).

²⁹ California Public Utilities Commission, “2008 Annual Report” at 65; available at
www.cpuc.ca.gov/PUC/aboutus/ under “annual reports”; visited January 22, 2010.

³⁰ For source data, see the sources cited in footnotes 30 to 33 of Global’s Closing Brief.

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Small water companies typically have limited technical, managerial and financial capabilities.³¹

Everyone agrees that the public interest is often served by the acquisition of these small water companies by larger, more capable companies. The question is: how do we get there? Traditional methods, like acquisition adjustments and ROE premiums, have made little progress and harm ratepayers by increasing rates. ICFA's allow a new method of using developer funds to help pay for acquisitions. But under the ROO, developer funds paid to the sellers of small water companies are treated as contributions, slashing rate base. Treating these funds as contributions creates a massively negative rate base for WUGT, destroys over \$20 million in used and useful plant investment in Pinal County, and forces \$32 million invested in the Southwest Plant to be written out of rate base forever.

³¹ Ex. A-12 (Rowell Direct) at 2.

1 If approved, the ROO will transform using developer funds for acquisitions into an act of
2 financial suicide, forever eliminating the most promising method for promoting water utility
3 consolidation in Arizona. If the ROO is adopted, the only methods of acquiring troubled water
4 companies will be either requiring ratepayers to pay for it, or finding philanthropic investors
5 willing to give away tens of millions of dollars so that developers can build more houses more
6 sustainably. And if adopted, the ROO will allow developers to keep forcing undercapitalized
7 utilities to do their bidding.

8 Global did not seek to pay large sums to acquire these companies; it is simply a fact of life
9 that the owners of these water utilities with large and valuable CC&Ns will not sell unless the
10 price is significantly higher than the utility's rate base. Small water utilities often have little or no
11 rate base – and frequently negative rate base.³² The Commission allows these utilities to recover
12 expenses (often including the owner's salary, and salary for company-employed family members),
13 plus an "operating margin" of profit on top of expenses.³³ A selling owner loses his or her salary
14 and the operating margin, and every family member on the payroll lose their salaries as well.
15 Thus, the owner has no financial motive to sell unless the price reflects these financial benefits –
16 in other words, the price must greatly exceed rate base. Staff witness Linda Jaress explained it this
17 way, when asked about a hypothetical utility with low rate base, where the owner, spouse and
18 relatives are on the payroll:

19 Q. So then to convince the owner to sell, the buyer would have to pay much more than
20 book value in this hypothetical?

21 A. To convince the owner to sell? If the owner wanted to maintain the income that he
22 had previously gotten from the utility, yes.³⁴

23 Thus, owners demand a price greater than rate base to sell these small utilities.

24 The key question is who pays for the acquisition? The only method suggested by Staff
25 was an "acquisition adjustment" – increasing rate base.³⁵ This causes rates to increase and it
26 means that customers pay for the cost of the acquisition. Understandably, the Commission has

27 ³² Tr. (Hill) at 57.

³³ Ex. A-8 (Hill Rebuttal) at 22-23; Tr. (Hill) at 56-57.

³⁴ Tr. (Jaress) at 813-815.

³⁵ Tr. at 788.

1 almost always rejected requests for acquisition adjustments.³⁶ Indeed, Ms. Jaress testified that she
2 was aware of only two cases where the Commission approved acquisition adjustments from the
3 early 1990s to the present.³⁷ In short, acquisition adjustments are rarely approved, and when they
4 are used, they increase rates. A better method of paying for acquisitions is needed.

5 **B. The solution – use developer funds to pay for acquisitions.**

6 The ICFA's are that better method. This method uses developer money to pay for the
7 acquisitions. Ratepayers benefit from the larger, more capable and financially sound owner, while
8 not having to pay for an acquisition adjustment.

9 Under traditional, orthodox ratemaking, an acquisition neither increases, nor decreases,
10 rate base.³⁸ The ROO departs from traditional ratemaking by deducting the acquisition price from
11 rate base. It does that by treating the \$43.8 million received from developers and paid to the
12 sellers of small utilities as contributions. The \$43.8 million was not used to pay for plant, and it is
13 not "available" for use to pay for plant. It was paid to the sellers, and is gone forever. The \$43.8
14 million should not increase rate base (as an acquisition adjustment); neither should it decrease rate
15 base, as proposed by the ROO. If amounts paid to sellers are *deducted* from rate base, acquisitions
16 simply will not make any financial sense.

17 In short, the ROO creates a significant financial disincentive for buying small water
18 utilities using developer funds. This disincentive is illustrated by the answers Staff witness Ms.
19 Jaress gave at the hearing when asked about a hypothetical "Jaress Utility Company" under the
20 following scenario:³⁹

- 21 • Jaress Utility Co. has a large CC&N area;
- 22 • Jaress Utility Co.'s rate base is funded by CIAC, so it has no rate base;
- 23 • A developer offers Sabo Corp. \$10 million to buy Jaress Utility Co.

24
25 ³⁶ Tr. at 792.

26 ³⁷ Tr. at 788 to 790.

27 ³⁸ Tr. (Rowell) at 416; Tr. (Jaress) at 802-804 (revenue requirement should remain the same before and after acquisition). *See also* A.A.C. R14-2-102.A.6 (original cost of utility assets determined at the time they are placed into service, not at the time of any subsequent sale of the assets).

³⁹ Tr. (Jaress) at 794:11 to 795:11.

1 Immediately before the sale, Jaress Utility Co. has a rate base of \$0. But Ms. Jaress testified that
2 the moment the deal closes, rate base drops from \$0 to negative \$10 million.⁴⁰ It is difficult
3 enough to buy a utility with no rate base; buying one with negative \$10 million in rate base makes
4 no sense. Who would lend money to such a utility, or invest equity in it?

5 Ms. Jaress also testified that if Sabo Corp. invests \$1 million in Jaress Utility Co., it will
6 not earn any return because of the negative rate base.⁴¹ Mr. Rigsby for RUCO gave the same
7 answers to an essentially identical hypothetical.⁴²

8 The ROO follows Ms. Jaress's approach. Under this approach, if a utility holding
9 company buys a small water utility, using money from a developer to pay for the acquisition, the
10 amount it pays is deducted from rate base – creating negative rate base. If the Commission
11 follows this recommendation, larger utilities (or utility holding companies) simply will not buy
12 smaller utilities using developer money. Adding developer money would be like adding poison to
13 a well – it would destroy whatever value the well had in the first place.

14 That simply makes no sense. The Commission should encourage – not discourage – using
15 developer money to pay for acquisitions. Indeed, developer money may be the only feasible way
16 to buy some of these small utilities. But it will not happen if the developer funds are treated as
17 contributions resulting in reduced rate base.

18 Global understands the concern of allowing developer-supplied funds into rate base –
19 that's why it is essential to demonstrate that the funds were used for acquisitions (or carrying
20 costs), not plant. The record is clear. Mr. Hill testified that Global spent \$43,871,802 in ICFA
21 fees on acquisitions of small water companies.⁴³ Staff's witness, Ms. Jaress, did not dispute that
22 Global spent the \$43,871,802 on acquisitions.⁴⁴ These developer funds did not go to plant – they
23 went to the former owners who sold the small utilities to Global. Because these developer funds
24

25
26 ⁴⁰ Tr. at 795:9-20.

27 ⁴¹ Tr. at 795:22-25.

⁴² Tr. at 661-663.

⁴³ Ex. A-7 (Hill Direct) at 32.

⁴⁴ Tr. at 881.

1 went to the sellers, they could not have been used to build plant. Thus, they should not be treated
2 as contributions. Instead, the \$43.8 million should neither increase, nor decrease, rate base.

3 **C. Negative rate base devastates utilities.**

4 As we have seen, developer funds can be used to pay for acquisitions. Treating those
5 funds as contributions and deducting them from rate base destroys any incentive to use developer
6 funds for acquisition – it just will not happen. But that is not the only problem. It also creates a
7 negative rate base – a ratemaking black hole that destroys future investments (and the incentive to
8 make those investments).

9 Global witness Matthew Rowell addressed the problems of negative rate base. As the
10 Commission's former Chief Economist, who served on the Commission's water task force, Mr.
11 Rowell has great experience with the perils of negative rate base. He explained "[t]he biggest
12 problem with negative rate base is that it destroys the incentive to invest in utility plant."⁴⁵ He
13 gave the example of a utility with a rate base of negative \$100,000 that needs \$50,000 in capital
14 improvements. If the utility invests the \$50,000, the rate base is still negative (minus \$50,000),
15 and the utility will never earn a return on its investment.⁴⁶ Compounding the problem, it is nearly
16 impossible for utilities with negative rate base to get financing, such as a loan. As Mr. Rowell
17 explained, obtaining financing for an investment that yields a zero return "would be very
18 difficult."⁴⁷ Mr. Hill made the same point in response to questions from Commissioner Pierce:

19 Q. It seems to me that distressed companies can get over their head just
20 because of a growth factor. And it seems to me that if they don't have the
21 ability to finance, that then CIAC works for them until the day of
reckoning when they realize they don't have anything in rate base.

22 ... [t]hey are looking for that day when growth comes and they sell,
because they really don't have the ability to stay in business, do they?

23 A. They really don't.

24 Q. They have to be able to have something that someone, a lending
25 organization, can get their arms around and there is a value attached to
that.... It boils down to that...., doesn't it?

26
27 ⁴⁵ Ex. A-13 (Rowell Rebuttal) at 27.

⁴⁶ Ex. A-13 (Rowell Rebuttal) at 28.

⁴⁷ Tr. (Rowell) at 332.

1 A. It does.”⁴⁸

2 The problem of negative rate base is dramatically illustrated by WUGT – under the ROO it
3 has a rate base of negative \$4.1 million.⁴⁹ So if Global invests \$1 million into WUGT, it will
4 never earn a return on that investment. As Staff explained, “If \$1 million was the only investment
5 in plant, then Staff would not recommend that the Company earn a rate of return....”⁵⁰ When
6 asked if this would have “any impact on a utility’s financial incentive to invest in plant”, Staff
7 could only reply “Staff does not know.”⁵¹ While Staff may not know, real world investors are not
8 going to invest \$1 million with no hope of ever earning a return on the investment. As Mr. Hill
9 explained, “[i]t makes it impossible to ever invest in that company again for any reason.”⁵² It is
10 simply poor policy to create a massive disincentive to investing in Arizona.

11 WUGT has about \$3.8 million in net plant in service, and about \$1.2 million in advances.⁵³
12 Logically, that leaves a maximum of \$2.6 million that could be rate base, or contributions. Indeed,
13 WUGT’s rate application showed a rate base of about \$2.6 million.⁵⁴ WUGT had little or no rate
14 base when it was purchased,⁵⁵ so the \$2.6 million reflects investments made after the purchase to
15 correct serious compliance problems.⁵⁶ The ROO wipes out this investment with a \$6.7 million
16 imputation of contributions, leaving a rate base of negative \$4.1 million.⁵⁷ The \$6.7 million was
17 part of \$23.9 million already paid to the former owners of WUGT.⁵⁸ The \$6.7 million was not
18 spent on plant, nor is it available for Global to “use”. It was paid to the former owner, and should
19 therefore not be considered a contribution.

20 A rate base of negative \$4.1 million destroys new equity or debt investment in WUGT.
21 The Commission should not leave WUGT in such an untenable position, nor does it make sense to

22 ⁴⁸ Tr. at 105.

23 ⁴⁹ ROO at 30.

24 ⁵⁰ Ex. A-40, Staff Response to Global 2.24.b.

24 ⁵¹ Ex. A-40, Staff Response to Global 2.24.c.

25 ⁵² Tr. (Hill) at 213.

25 ⁵³ Staff Final Schedules, WUGT, Surrebuttal Schedule CSB-3.

26 ⁵⁴ Staff Final Schedules, WUGT, Surrebuttal Schedule CSB-3, Column A, line 14.

26 ⁵⁵ Ex. A-13 (Rowell Rebuttal) at 24.

27 ⁵⁶ Tr. (Hill) at 213; Ex. A-13 (Rowell Rebuttal) at 28.

27 ⁵⁷ Staff Final Schedules, WUGT, Surrebuttal Schedule CSB-3.

27 ⁵⁸ Ex. A-33, payments for 2006 through 2008 for West Maricopa Combine.

1 create a huge disincentive to investing in WUGT. The negative rate base is especially troubling
2 because WUGT was a deeply troubled utility that faced significant arsenic and other compliance
3 problems, requiring substantial investment. WUGT should be a shining example of the kind of
4 acquisitions the Commission should support, but if the Commission adopts the ROO, it will be
5 telling the investment community, “don’t ever try using developer money to buy troubled utilities
6 again.” That is not the right message to send. Moreover, WUGT will need large investments in
7 the future, as it is in a projected high growth area with serious water supply issues – which is why
8 it is at the forefront of Global’s plans to promote the use of recycled water in communities like
9 Belmont. It needs to be able to attract those investments.

10 **IV. Taxes.**

11 Only after-tax ICFA funds should be considered when determining the amount of
12 contributions generated by the ICFA funds. The bottom line is that you can’t spend money that
13 you paid to the government as taxes. Everyone who gets a paycheck knows this – the check is in
14 after-tax dollars.

15 Staff’s witness, Ms. Jaress, conceded that “the receipt of ICFA fees does generate a tax
16 liability.”⁵⁹ The tax liability generated by ICFA funds through the end of 2008 was \$24,057,683.⁶⁰
17 Because this \$24 million was paid as a tax liability, it was not available to be invested in plant, and
18 thus should not be imputed as contributions.

19 This is not a new issue. The Commission has consistently found that only the after-tax
20 portion of funds received from developers should be treated as contributions.⁶¹ For example, Ms.
21 Jaress testified that if a water utility received \$150,000 from a developer, but had to pay \$50,000
22 of that in taxes, then only \$100,000 (the after-tax amount) is treated as a contribution.⁶² Here,
23 Global Parent received \$60,084,123 in ICFA revenues, and incurred \$24,057,683 in tax liability
24 on this amount. Thus, only \$36,026,440 would be eligible for consideration as contributions.

25
26

⁵⁹ Tr. (Jaress) at 781.

27 ⁶⁰ Ex. A-13 (Rowell Rebuttal) at 35.

⁶¹ Tr. (Jaress) at 732-33.

⁶² Id.

1 The ROO agrees with Staff's argument that the \$24 million tax liability should be
2 disregarded because Global Parent is a LLC. The ROO draws an analogy to setting revenue
3 requirement – the Commission typically does not allow income tax expense as a part of revenue
4 requirement for utilities that are LLCs.⁶³ But the Commission is not setting a revenue requirement
5 for Global Parent. Instead, the Commission is determining what amount of ICFA funds could
6 possibly have been invested in plant. The Commission has traditionally calculated contributions
7 based on after-tax dollars; there is no reason to alter this traditional approach.

8 Even if the LLC argument was correct, the Commission has authorized a reorganization of
9 Global under which Global Parent becomes a corporation.⁶⁴ Global anticipates that the
10 reorganization will happen this year. Thus, even if the Commission adopts the ROO's position on
11 the LLC issue, the Commission should determine that only after-tax ICFA funds will be
12 considered for imputation as contributions once Global Parent reorganizes as a corporation.

13 **V. Accounting.**

14 The real dispute between Staff and Global regarding ICFA funds is whether the *source of*
15 *funds* determines its designation (CIAC or not), or whether the *use of those funds* determines the
16 designation. Staff raised various observations about the color coding of ICFA revenues.⁶⁵ While
17 the ROO does not rely on these arguments in its ICFA conclusion, a brief response is appropriate.
18 Global's books are audited by Deloitte & Touche. Moreover, no party challenged a single dollar
19 of the Global Utilities' plant in service, nor was even a dollar of revenue disputed. There were no
20 material disagreements over expenses. While cost allocation has been a contentious issue in a
21 number of recent water rate cases, no party challenged Global's cost allocation methods. Further,
22 when Global used IDA bonds to build plant, Global only receives the funds after submitting
23 detailed invoices to US Bank, the trustee that oversees the funds.⁶⁶ Global's IDA spending is also
24 audited in detail to ensure it qualifies for tax-free bond status.⁶⁷

25 _____
26 ⁶³ See ROO at 28.

27 ⁶⁴ Decision No. 70980 (May 5, 2009).

⁶⁵ ROO at 22-26.

⁶⁶ Tr. (Hill) at 220-225; See Ex. S-34.

⁶⁷ Tr. (Hill) at 220-225.

1 Global's financial statements – audited by Deloitte & Touche – provided significant detail
2 on the uses of ICFA funds.⁶⁸ In addition, Staff conducted a lengthy on-site audit, was provided
3 access to all records and books, was provided copies of all requested information and was never
4 denied access to any information.⁶⁹

5 Moreover, Staff's professed inability to follow a specific dollar from receipt to use appears
6 to be a red herring, because Staff testified that its position would not change even if Global's
7 accounting met all Staff's expectations. It bears repeating that Global's accounting records are
8 audited by Deloitte & Touche, a well-regarded firm which also audits APS. Staff's witness Ms.
9 Jaress testified that Staff's recommendation would not change, even if the ICFA funds had been
10 deposited into a "segregated, separate, isolated bank account walled off from all the company's
11 other bank accounts, and that bank account was used for some other purpose than plant."⁷⁰ On
12 acquisitions, she testified that even if Global "spent all the \$43 million on acquisitions from ICFA
13 fees", Staff would not change its position.⁷¹ Likewise, on taxes, she testified Staff would not
14 recognize a tax offset "even if they could prove that all \$24 million went to the IRS".⁷² In sum,
15 her position was that "developer-provided funds should be treated as CIAC regardless of what
16 purpose they were used for."⁷³ This is the true disagreement between Global and Staff – Global
17 believes that use of the funds must be considered.

18 If the ICFA funds were used for plant, they should be contributions. But if they were paid
19 to a former utility owner to buy a small utility, or used to cover the carrying costs on the regional
20 plant needed for TWM, then they did not go into plant, and should not be contributions. Likewise,
21 money paid to the government as taxes did not go into plant, and should not be contributions.
22 Indeed, on cross-examination, Ms. Jaress conceded that the use of the funds does matter:

23 Q. So if funds from a developer are provided to a utility holding company for a non-
24 utility service, then it should not be treated as CIAC?

25 ⁶⁸ Ex. S-3 at 11, 18-21, and 28-29.

26 ⁶⁹ Tr. (Jaress) at 844.

27 ⁷⁰ Tr. (Jaress) at 811.

⁷¹ Tr. (Jaress) at 855.

⁷² Tr. (Jaress) at 736.

⁷³ Tr. (Jaress) at 810.

1 A. Yes.

2 The Commission should consider the use of the ICFA funds, and not designate ICFA funds to be
3 contributions if they were used to cover the carrying costs of regional plant, pay for acquisitions,
4 or pay for tax liabilities.

5 **VI. Non-Potable Water Phase-In.**

6 It appears that the ROO inadvertently omitted Global's proposal to phase-in non-potable
7 water rates in Maricopa over five years.⁷⁴ As with the other phase-in, the forgone revenues will
8 not be recovered. The phase-in will help large non-potable water users, such as homeowner's
9 associations, to gradually adjust their usage over the five years phase-in period. No party opposed
10 this proposal, and the Commission should approve it.

11 **VII. Technical error in rate base.**

12 RUCO proposed adjustments to gross plant in service and accumulated depreciation
13 (RUCO Rate Base Adjustments Nos. 1 and 2).⁷⁵ Global accepted these RUCO adjustments.⁷⁶ The
14 ROO did not address this issue, and accordingly uses the wrong starting point in addressing the
15 rate base adjustments for ICFAs. The effect is to understate rate base by \$1,164,427. The revenue
16 impact of this technical correction is included in Exhibit 1. However, if Exhibit 1 is not adopted, a
17 separate amendment should be made to correct this technical error.

18 **VIII. Conclusion.**

19 The ICFA represents an important new policy tool to promote: (1) TWM, including
20 regional plant and use of recycled water; and (2) consolidation of small water companies by larger
21 companies with greater technical, managerial and financial resources. In addition, funds paid for
22 tax liabilities could not have been spent on plant. Thus, the Commission should not treat ICFA
23 funds as contributions when the funds are used to:

- 24 (1) offset the carrying costs of regional TWM infrastructure until it can be placed into
25 rate base;

26
27 ⁷⁴ See Global Br. at 7:10-12.

⁷⁵ Ex. RUCO-1 (Moore Direct at 9-10); Ex. RUCO-2 (Moore Surrebuttal) at 3.

⁷⁶ Global Br. at 58-59.

- 1 (2) pay for undercapitalized water and wastewater companies; or
 2 (3) cover the tax liabilities created by receiving ICFA funds.

3 Under no circumstances should the Commission create a huge negative rate base, like the
 4 negative \$4.1 million rate base for WUGT, simply because developer money was used to pay the
 5 former owner.

6 The Commission has repeatedly recognized the importance of sustainability in recent
 7 orders. A vision for a sustainable future inspired the Commission's orders approving the Electric
 8 Energy Efficiency Rules, the revision and restoration of the Integrated Resource Planning Rules,
 9 and the Commission's Solar City order regarding Solar Services Agreements. For example, in
 10 *Solar City* the Commission recognized that the public interest was best served by addressing long-
 11 term sustainability, and that the SSAs furthered that goal.⁷⁷ The Commission should find that
 12 TWM and acquisitions are in the public interest, and indeed, are important for Arizona's future.

13 For all these reasons, the Commission should find that the ICFA funds, under the facts of
 14 this case, are not contributions. A proposed amendment is attached as Exhibit 1. This proposed
 15 amendment will increase the aggregate revenue requirement of the six Global Utilities over the
 16 ROO by \$3,664,021, resulting in a total increase of \$13,957,489. Exhibit 1 affects three utilities:

17 Utility	18 Increase over ROO ⁷⁸	19 Bill increase (Median User)	20 Total increase over present rates	21 Total bill increase (Median User)
19 Santa Cruz	\$1,120,212	\$6.25	\$3,045,760	(\$0.40) ⁷⁹
20 Palo Verde	\$1,817,991	\$12.10	\$8,262,891	\$39.86
21 WUGT	\$635,818	\$56.46	\$613,505	\$46.35

22 However, if the Commission believes that, despite the significant steps Global has taken to
 23 minimize rates, it needs to adopt lower rates so as to mitigate the impact to customers in a difficult
 24 economic recession, the Commission should still support TWM and consolidation of small utilities
 25 in the future by approving the ICFA for those purposes. Accordingly, attached as Exhibit 2 is a
 26 _____

27 ⁷⁷ Decision No. 71795 (July 12, 2010) at 53.
⁷⁸ Includes Hearing Division Amendment No. 1 as part of ROO.
⁷⁹ Median user has a decrease due to volumetric rebate.

1 revenue-neutral amendment, that approves an accounting order to defer rate base recognition until
2 Global's next rate case.

3 Attached as Exhibit 3 is a proposed amendment to approve Global's proposed 5-year phase
4 in for Palo Verde's non-potable water rates. If Exhibit 1 is not adopted, a further amendment
5 should be made to correct the technical rate base issue.

6 RESPECTFULLY SUBMITTED this 4th day of August 2010.

7 ROSHKA DEWULF & PATTEN, PLC

8
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34

By *Missie Arnold*

Exhibit

"1"

Exhibit 1

Proposed Amendment – ICFA issues

PAGE 29, LINE 16, AFTER, “through which Global Parent agreed to”, DELETE remainder of paragraph through PAGE 30, LINE 9 and INSERT:

“provide for the planning, coordination, and financing necessary for utility service; and in some cases to acquire water companies.

To ascertain whether the ICFA revenues were contributions in aid of construction, or merely revenues provided to Global Parent for those services, we must first decide whether the source of the funds or the actual use of the funds determines their regulatory treatment. Staff contends that the use of the funds does not matter, while Global contends that the use of the funds is an important factor. The purpose of CIAC is to ensure that ratepayers are not forced, in their rates, to pay a return on plant paid for by developers, not investors. We evaluate this issue with this fundamental purpose of CIAC in mind. Where the use of ICFA funds is consistent with this purpose, we will not automatically consider those funds to be CIAC.

a. Carrying Costs and Total Water Management

None of the parties dispute the benefits of Global’s Total Water Management approach; all the parties agree that Global has in fact invested in and built the systems required by that approach. Global’s results have been significant – its operating expenses are significantly lower than other, similar systems; its use of groundwater is forty percent less than similarly situated systems; and it has become one of the State’s leaders in long-term water resource planning. Indeed, Global has been recognized by ADWR and ADEQ for its leadership in regional planning and conservation.¹

Global argues, and we agree, that when the developer provides the funding to build utility plant, the developer has a significant amount of leverage over the type of plant that is built. All too often, that means that water and wastewater systems are scaled only to meet the needs of one development at a time. This leads to higher operating expenses because the resulting utility is not a regionally-planned system; rather it is an amalgamation of subdivision-sized assets (numerous wells, numerous lift stations) built to meet the needs of individual developments. Those increased expenses become a permanent part of rates.²

¹ See letters dated Nov. 16, 2009 by Karen Smith, Deputy Director ADWR and Nov. 19, 2009 by Benjamin H. Grumbles, Director, ADEQ filed in Docket No. SW-20422A-06-0566.

² Rebuttal Testimony of Matthew Rowell, pages 18-22

This Commission has long been concerned with long-term water resource planning, and we have encouraged water and wastewater utilities to integrate – allowing reclaimed water to supplant groundwater use throughout communities and incenting groundwater recharge. We recognize that regional scale is essential to meeting regional water challenges. In this case, Global has taken all of those important steps.

We find that the record in this case demonstrates a clear connection between the ICFA and long-term water resource planning on a regional scale that includes reclamation and reuse, conservation, and recharge. As Staff witness Linda Jaress testified:

I think that the ICFAs make building regional plant easier. It's not exactly what you asked me, but the total water management, when it has to do with building plant way ahead of growth might be difficult for Global to find financing for because it's risky. We can see what happened with the Southwest Plant. So the ICA fund provides money, I think, for plant that would be difficult for Global to finance elsewhere.³

We also find that there is a connection between long-term water resource planning on a regional scale and the risk of carrying costs that are not recoverable in rates.⁴

Global's commitment to Total Water Management is laudable and it brings many benefits, but it exacerbates the carrying cost issue. Building regional plant increases the risk of unused plant – in this case all the parties support Global's voluntary exclusion of \$32 million of unused plant (the "Southwest Plant") from rate base. Global financed this plant by primarily using IDA bonds. The parties agree that Global continues to bear the financing costs of that plant through the IDA bonds and that there is a link between the bonds, the utilities and the plant.⁵ Where the parties disagree is whether the cost of plant is CIAC, because Global used ICFA revenues to partially cover the interest on the IDA bonds used to build the Southwest Plant.

Global states that it uses ICFA fees to pay the carrying costs of regional infrastructure (such as the Southwest Plant) until the plant is used and useful. Global thus asserts that the ICFA fees provide a shield to ratepayers, protecting them from paying for regionally-sized infrastructure that may not become used when expected, should development slow or stop.

Overall, Global paid \$7,844,179.26 in interest on IDA bonds for the years 2007 – 2008.⁶ We find that the interest paid on IDA bonds is a reasonable proxy for carrying costs in this case. We agree with Global that using ICFA fees to partially cover the carrying cost of unused regional plant is in the public interest. Therefore, we will not consider ICFA

³ Tr. at 750 (emphasis added).

⁴ Tr. at 865 (testimony of Staff witness Linda Jaress).

⁵ Tr. at 770 (testimony of Staff witness Linda Jaress).

⁶ Rejoinder Testimony of Trevor Hill (Exh. A-9) at Exh. 5.

fees to be CIAC when those fees are used to cover carrying costs for regional plant used for Total Water Management.

b. ICFA fees used for Acquisitions

The record in this case shows that Global Parent received \$60,084,123 in ICFA fees, and while we agree with Staff's concern about the separation of the funds from owner equity and IDA debt, we recognize that the record shows that: (1) Global Parent has spent \$83,080,153 for acquisitions; and (2) that \$43,871,802 of that expense was paid with ICFA fees.⁷

All parties agree that the cost of acquisitions should rarely, if ever, be passed onto ratepayers. Staff's witness testified that the Commission has allowed acquisition adjustments only twice in the last twenty years.⁸ All parties also agree that since the Commission's 1999 Water Task Force report, the number of water companies has increased and consolidation has not occurred to the extent necessary to allow economies of scope and scale. Arizona faces now, and will increasingly face in the future, serious water challenges as economic growth resumes and as water scarcity increases. Arizona's multitude of small water companies lack the resources to meet these challenges.

We are concerned with the proliferation of small water companies. As growth leads to development in exurban areas, many small companies face serious supply issues but lack the means to address these issues. However, it is very difficult for larger, more sophisticated companies to buy these small companies. The buyer must pay more than the rate base value of the system because the CC&Ns of these undercapitalized companies are much more valuable than their utility plant and the small system's owner may derive significant income from the operating margin. Unless we grant an acquisition adjustment, that buyer cannot recover the amount paid above book value. This creates an economic disincentive to consolidation. Staff witness Linda Jaress illustrated this disincentive under cross-examination by WUAA, when asked about paying \$100,000 for a utility with no rate base: "Then you [the buyer] would want to maybe look at that transaction again."⁹ She explained that the buyer would not earn a return on the amount it paid above rate base:

That is what original cost rate base is. And just because you sell the plant and find some other value other than a return on it from the Commission doesn't automatically change the book value of the plant. The value is the book value is the book value. And if the book value is zero and you pay \$1 million for it, the ratepayer shouldn't have to pay any more return on that plant because its book value is zero.¹⁰

⁷ Tr. at 880 (Testimony of Linda Jaress for Staff).

⁸ Tr. at 788 (Testimony of Linda Jaress for Staff).

⁹ Tr. at 739.

¹⁰ Tr. at 741.

Thus, there is a significant economic disincentive to paying more than book value. And under Staff's approach, if the funds originally came from a developer, the rate base is reduced by the amount paid over book value, further discouraging such payments. Yet the record shows that such payments over book value are often necessary to convince owners to sell. Ms. Jaress testified that in order to convince an owner of a utility with little or no rate base to sell, "[i]f the owner wanted to maintain the income that he had previously gotten from the water utility" the buyer must pay much more than rate base.¹¹

Staff's main concern is that the utility should not earn a return on developer-provided funds. We share this concern. However, because Global will receive no return on the premium it paid above rate base to buy the small utilities, and because Global is not seeking to adjust rate base as a result of the acquisition, there is no danger that Global will receive a return on ICFA revenues allocated to acquisitions.

The parties agree that Global is the only company that has recently been able to acquire these types of companies.¹² It did so by using developer funds to buy undercapitalized water utilities.

In this case, we find that the ICFA fees used for acquisitions are not CIAC. We find that the use of ICFA fees for acquisitions, when it results in consolidation and regional planning, avoids acquisition adjustments, and leads to long-term water resource planning, is in the public interest.

c. Tax Liability on ICFA Fees

There are two questions regarding the tax liability on ICFA fees – the first is whether ICFA fees are strictly CIAC. The second is whether the structure of Global Parent as an LLC provides the Commission sufficient certainty as to whether the distributions made to members for taxes were actually paid to the government as taxes. As Staff points out, while the \$24,057,683 was calculated and distributed to the Global Parent LLC members to offset their tax liability, the individual members of that LLC may have had other tax gains and losses that affected whether that entire amount was paid in taxes.

With regards to the first question of whether ICFA fees are strictly CIAC, we have found that ICFA fees for acquisitions of undercapitalized utilities and for carrying costs related to regional plant were not CIAC.¹³ This still leaves some ICFA fees we view as potentially CIAC. Thus, we turn to the second question – whether the structure of Global Parent provides the Commission certainty as to the tax liability of its members and the taxes actually paid by those members. In Decision No. 70980 (May 5, 2009), we approved Global's application to reorganize from an LLC structure to a corporation –

¹¹ Tr. at 815.

¹² Tr. at 641 (Testimony of William Rigsby for RUCO) Tr. at 819 and 880 (Testimony of Linda Jaress for Staff).

¹³ Of the \$60,084,123 received, we have allocated \$43,871,802 to acquisitions and \$7,539,796.88 to carrying costs – a total of \$51,411,598.88; leaving \$8,672,524.12.

upon completion of that reorganization, Global's tax structure will be more in line with other utility holding companies. The ICFA revenues will however continue to be subject to tax liability and therefore we will address our general position on the tax consequences of ICFA revenues as it would relate to any corporate structure.

We agree with WUAA, that taxes paid to the government on ICFA fees do not go into rate base. Irrespective of the corporate structure, as Global continues to receive ICFA fees, it will incur a tax liability and that liability must be recognized. It is appropriate, then, to deduct the tax liability associated with ICFA funds prior to any potential CIAC imputation.

In this case, the record shows the \$24,057,683 was distributed to the members of Global Parent for tax liability and as WUAA points out it could not have been used for plant.

d. ICFA Summary

We find that ICFAs can provide the necessary incentives and funding to achieve the Commission's goals for consolidation of undercapitalized utilities and regionalized plant that allow for sustainability. We find that ICFAs generate a tax liability regardless of the corporate structure and that liability must be recognized. We find that funds received from developers must be considered CIAC if they are used to construct utility plant. We find that funds received from a developer that are employed for consolidation of undercapitalized utilities and carrying costs of regional plant should not be treated as CIAC.

We have developed the following principles to assess ICFA-style revenue:

1. ICFA revenue used to construct utility plant will be considered CIAC.
2. Only after-tax ICFA revenue will be considered as potential CIAC.
3. All after-tax ICFA revenue will be treated as CIAC unless it is offset by:
 - a. the carrying costs associated with regional plant used for Total Water Management; and/or
 - b. the cost of purchasing undercapitalized utilities.

In the case of acquisitions, the following additional criteria apply:

1. The use of developer funds for an acquisition shall preclude any application for an acquisition adjustment.
2. The buyer must own and operate one or more utilities with more customers, more revenue, and more plant-in-service than the acquired company, thus providing an increase in technical, managerial and financial capabilities for the acquired company.

3. The acquisition must be part of a regional plan of consolidation and conservation – it is not our intent to encourage ‘cherry-picking’ of already healthy systems, rather it is to provide a tool that allows a fair price to be paid while protecting ratepayers from paying for the cost of growth, and which leads to more effective regional water resource planning and conservation.
4. The developer(s) shall not exercise control over the utility system, management, or planning as a result of the ICFA.

Although we recognize the ongoing nature of carrying costs, for the purposes of this case we agree with Global that it is reasonable to use the \$7,423,541 in interest payments on the IDA bonds as the carrying cost offset. In future cases the Company will have the burden to demonstrate the appropriateness of its proposed carrying cost offset.

For purposes of this case we find that the \$43,871,802 Global identified as acquisition premiums for which ICFA revenues were used as an offset meet the four criteria for acquisitions specified above. In future rate cases it will be the Company’s burden to demonstrate that ICFA revenues used for acquisition costs meet the four criteria for acquisitions specified above.

The offsets to ICFA revenues are summarized here:

Post-Tax ICFA Revenues	\$36,026,440
Less Carrying Cost of TWM Plant	\$7,844,179
Less Acquisition Costs	\$43,871,802
 ICFA Revenues eligible for CIAC treatment	 (\$15,689,541)

Since the ICFA revenues are more than offset by the carrying cost of TWM plant and the acquisition costs, we will not treat any of the ICFA revenues as CIAC in this case.

Further edits to conform to the above discussion:

- Page 30 line 17: Delete: “\$53,314,083”
Insert: “\$64,011,238”
- Page 30 Line 17: Delete: “\$39,155,692”
Insert: “\$45,902,454”
- Page 30 Line 17: Delete: “(\$4,186,150)”
Insert: “\$2,563,849”
- Page 33 line 18: Between “...adjustments.” and “Staff’s...” Insert: “Because Staff’s rate base adjustments are not being adopted,”

Page 33 line 19: Between "...will" and "be adopted." Insert: "not"

Page 49 line 11: Delete: "N/A"
Insert: "40/60"

Page 50 Line 10: Delete: "N/A"
Insert: "6.3%"

Page 54 Line 17.5 – Page 55 line 16: Delete all of Section "E. WUGT Operating Margin"

Page 54 Line 17.5 Insert:

<u>WUGT</u>			
	Percentage	Cost	Weighted Cost
Debt	40%	6.3%	2.52%
Common Equity	60%	9.8%	5.88%
Weighted Average Cost of Capital			8.40%

Page 55 line 23: Delete: "\$6,444,900 or 97.01"
Insert: "8,262,891 or 124"

Page 55 line 24 through end of page: Delete:

Fair Value Rate Base	\$	53,314,083
Adjusted operating Income	\$	514,971
Required Fair Value Rate of Return		8.23%
Required operating Income	\$	4,387,749
Operating Income Deficiency	\$	3,872,778
Gross Revenue Conversion Factor		1.66415
Gross Revenue increase	\$	6,444,900

Insert:

Fair Value Rate Base	\$	64,011,238
Adjusted operating Income	\$	302,893
Required Fair Value Rate of Return		8.23%
Required operating Income	\$	5,268,125
Operating Income Deficiency	\$	4,965,232
Gross Revenue Conversion Factor		1.66415
Gross Revenue increase	\$	8,262,891

Page 56 line 18: Delete: "\$1,835,548 or 19.51"
Insert: "\$3,045,760 or 32"

Page 56 line 19 through 22.5: Delete:

Fair Value Rate Base	\$	39,155,692
Adjusted operating Income	\$	2,178,255
Required Fair Value Rate of Return		8.38%
Required operating Income	\$	3,281,247
Operating Income Deficiency	\$	1,102,992
Gross Revenue Conversion Factor		1.66415
Gross Revenue increase	\$	1,835,544

Insert:

Fair Value Rate Base	\$	45,902,454
Adjusted operating Income	\$	2,016,406
Required Fair Value Rate of Return		8.38%
Required operating Income	\$	3,846,626
Operating Income Deficiency	\$	1,830,220
Gross Revenue Conversion Factor		1.66415
Gross Revenue increase	\$	3,045,760

Page 56 line 24.5: Delete: "The adjusted test year operating income for WUGT was \$33,121. An 8.26 percent operating margin results in operating income of \$19,575."

Page 56 line 26.5: Delete: "decrease by \$22,313 or 8.60"
Insert: "increase by \$613,505 or 237%"

Page 56 line 27.5 through page 57 line 3: Delete:

Fair Value Rate Base	\$	(4,186,750)
Adjusted operating Income	\$	33,121
Operating margin		8.26%
Required operating Income	\$	19,575
Operating Income Surplus	\$	(13,546)
Gross Revenue Conversion Factor		1.65332
Gross Revenue increase	\$	(22,313)

Insert:

Fair Value Rate Base	\$	2,563,849
Adjusted operating Income	\$	(155,711)
Required Fair Value Rate of Return		8.40%
Required operating Income	\$	215,363
Operating Income Deficiency	\$	371,074

Gross Revenue Conversion Factor 1.65332
Gross Revenue increase \$ 613,504.59

Page 78 line 5: Delete: "\$53,314,083"
 Insert: "\$64,011,238"

Page 78 line 12: Delete: "39,155,692"
 Insert: "\$45,902,454"

Page 78 line 14.5: Delete: "(\$4,186,150) and an operating margin of 8.26"
 Insert: "\$2,563,849 and a rate of return of 8.4"

Page 78 line 21.5: Delete: "\$6,444,900"
 Insert: "\$8,262,891"

Page 78 line 25: Delete: "\$1,835,548"
 Insert: "\$3,045,760"

Page 78 line 26: Delete: "decrease by \$22,313"
 Insert: "increase by \$613,505"

Page 82 line 24: Delete: "\$53,314,083"
 Insert: "\$64,011,238"

Page 83 line 5: Delete: "39,155,692"
 Insert: "\$45,902,454"

Page 83 line 7: Delete: "(\$4,186,150), and applying an operating margin of 8.26"
 Insert: "\$2,563,849 and applying a rate of return of 8.4"

MAKE ALL CONFORMING CHANGES

Exhibit

"2"

Exhibit 2

Proposed Amendment – ICFA Issues (Revenue Neutral)

PAGE 29, LINE 16, AFTER, “through which Global Parent agreed to”, DELETE remainder of paragraph through PAGE 30, LINE 9 and INSERT:

“provide for the planning, coordination, and financing necessary for utility service; and in some cases to acquire water companies.

To ascertain whether the ICFA revenues were contributions in aid of construction, or merely revenues provided to Global Parent for those services, we must first decide whether the source of the funds or the actual use of the funds determines their regulatory treatment. Staff contends that the use of the funds does not matter, while Global contends that the use of the funds is an important factor. The purpose of CIAC is to ensure that ratepayers are not forced, in their rates, to pay a return on plant paid for by developers, not investors. We evaluate this issue with this fundamental purpose of CIAC in mind. Where the use of ICFA funds is consistent with this purpose, we will not automatically consider those funds to be CIAC.

a. Carrying Costs and Total Water Management

None of the parties dispute the benefits of Global’s Total Water Management approach; all the parties agree that Global has in fact invested in and built the systems required by that approach. Global’s results have been significant – its operating expenses are significantly lower than other, similar systems; its use of groundwater is forty percent less than similarly situated systems; and it has become one of the State’s leaders in long-term water resource planning. Indeed, Global has been recognized by ADWR and ADEQ for its leadership in regional planning and conservation.¹

Global argues, and we agree, that when the developer provides the funding to build utility plant, the developer has a significant amount of leverage over the type of plant that is built. All too often, that means that water and wastewater systems are scaled only to meet the needs of one development at a time. This leads to higher operating expenses because the resulting utility is not a regionally-planned system; rather it is an amalgamation of subdivision-sized assets (numerous wells, numerous lift stations) built to meet the needs of individual developments. Those increased expenses become a permanent part of rates.²

¹ See letters dated Nov. 16, 2009 by Karen Smith, Deputy Director ADWR and Nov. 19, 2009 by Benjamin H. Grumbles, Director, ADEQ filed in Docket No. SW-20422A-06-0566.

² Rebuttal Testimony of Matthew Rowell, pages 18-22

This Commission has long been concerned with long-term water resource planning, and we have encouraged water and wastewater utilities to integrate – allowing reclaimed water to supplant groundwater use throughout communities and incenting groundwater recharge. We recognize that regional scale is essential to meeting regional water challenges. In this case, Global has taken all of those important steps.

We find that the record in this case demonstrates a clear connection between the ICFA and long-term water resource planning on a regional scale that includes reclamation and reuse, conservation, and recharge. As Staff witness Linda Jaress testified:

I think that the ICFAs make building regional plant easier. It's not exactly what you asked me, but the total water management, when it has to do with building plant way ahead of growth might be difficult for Global to find financing for because it's risky. We can see what happened with the Southwest Plant. So the ICA fund provides money, I think, for plant that would be difficult for Global to finance elsewhere.³

We also find that there is a connection between long-term water resource planning on a regional scale and the risk of carrying costs that are not recoverable in rates.⁴

Global's commitment to Total Water Management is laudable and it brings many benefits, but it exacerbates the carrying cost issue. Building regional plant increases the risk of unused plant – in this case all the parties support Global's voluntary exclusion of \$32 million of unused plant (the "Southwest Plant") from rate base. Global financed this plant by primarily using IDA bonds. The parties agree that Global continues to bear the financing costs of that plant through the IDA bonds and that there is a link between the bonds, the utilities and the plant.⁵ Where the parties disagree is whether the cost of plant is CIAC, because Global used ICFA revenues to partially cover the interest on the IDA bonds used to build the Southwest Plant.

Global states that it uses ICFA fees to pay the carrying costs of regional infrastructure (such as the Southwest Plant) until the plant is used and useful. Global thus asserts that the ICFA fees provide a shield to ratepayers, protecting them from paying for regionally-sized infrastructure that may not become used when expected, should development slow or stop.

Overall, Global paid \$7,844,179.26 in interest on IDA bonds for the years 2007 – 2008.⁶ We find that the interest paid on IDA bonds is a reasonable proxy for carrying costs in this case. We agree with Global that using ICFA fees to partially cover the carrying cost of unused regional plant is in the public interest. Therefore, we will not consider ICFA

³ Tr. at 750 (emphasis added).

⁴ Tr. at 865 (testimony of Staff witness Linda Jaress).

⁵ Tr. at 770 (testimony of Staff witness Linda Jaress).

⁶ Rejoinder Testimony of Trevor Hill (Exh. A-9) at Exh. 5.

fees to be CIAC when those fees are used to cover carrying costs for regional plant used for Total Water Management.

b. ICFA fees used for Acquisitions

The record in this case shows that Global Parent received \$60,084,123 in ICFA fees, and while we agree with Staff's concern about the separation of the funds from owner equity and IDA debt, we recognize that the record shows that: (1) Global Parent has spent \$83,080,153 for acquisitions; and (2) that \$43,871,802 of that expense was paid with ICFA fees.⁷

All parties agree that the cost of acquisitions should rarely, if ever, be passed onto ratepayers. Staff's witness testified that the Commission has allowed acquisition adjustments only twice in the last twenty years.⁸ All parties also agree that since the Commission's 1999 Water Task Force report, the number of water companies has increased and consolidation has not occurred to the extent necessary to allow economies of scope and scale. Arizona faces now, and will increasingly face in the future, serious water challenges as economic growth resumes and as water scarcity increases. Arizona's multitude of small water companies lack the resources to meet these challenges.

We are concerned with the proliferation of small water companies. As growth leads to development in exurban areas, many small companies face serious supply issues but lack the means to address these issues. However, it is very difficult for larger, more sophisticated companies to buy these small companies. The buyer must pay more than the rate base value of the system because the CC&Ns of these undercapitalized companies are much more valuable than their utility plant and the small system's owner may derive significant income from the operating margin. Unless we grant an acquisition adjustment, that buyer cannot recover the amount paid above book value. This creates an economic disincentive to consolidation. Staff witness Linda Jaress illustrated this disincentive under cross-examination by WUAA, when asked about paying \$100,000 for a utility with no rate base: "Then you [the buyer] would want to maybe look at that transaction again."⁹ She explained that the buyer would not earn a return on the amount it paid above rate base:

That is what original cost rate base is. And just because you sell the plant and find some other value other than a return on it from the Commission doesn't automatically change the book value of the plant. The value is the book value is the book value. And if the book value is zero and you pay \$1 million for it, the ratepayer shouldn't have to pay any more return on that plant because its book value is zero.¹⁰

⁷ Tr. at 880 (Testimony of Linda Jaress for Staff).

⁸ Tr. at 788 (Testimony of Linda Jaress for Staff).

⁹ Tr. at 739.

¹⁰ Tr. at 741.

Thus, there is a significant economic disincentive to paying more than book value. And under Staff's approach, if the funds originally came from a developer, the rate base is reduced by the amount paid over book value, further discouraging such payments. Yet the record shows that such payments over book value are often necessary to convince owners to sell. Ms. Jaress testified that in order to convince an owner of a utility with little or no rate base to sell, "[i]f the owner wanted to maintain the income that he had previously gotten from the water utility" the buyer must pay much more than rate base.¹¹

Staff's main concern is that the utility should not earn a return on developer-provided funds. We share this concern. However, because Global will receive no return on the premium it paid above rate base to buy the small utilities, and because Global is not seeking to adjust rate base as a result of the acquisition, there is no danger that Global will receive a return on ICFA revenues allocated to acquisitions.

The parties agree that Global is the only company that has recently been able to acquire these types of companies.¹² It did so by using developer funds to buy undercapitalized water utilities.

In this case, we find that the ICFA fees used for acquisitions should not be CIAC. We find that the use of ICFA fees for acquisitions, when it results in consolidation and regional planning, avoids acquisition adjustments, and leads to long-term water resource planning, is in the public interest.

c. Tax Liability on ICFA Fees

There are two questions regarding the tax liability on ICFA fees – the first is whether ICFA fees are strictly CIAC. The second is whether the structure of Global Parent as an LLC provides the Commission sufficient certainty as to whether the distributions made to members for taxes were actually paid to the government as taxes. As Staff points out, while the \$24,057,683 was calculated and distributed to the Global Parent LLC members to offset their tax liability, the individual members of that LLC may have had other tax gains and losses that affected whether that entire amount was paid in taxes.

With regards to the first question of whether ICFA fees are strictly CIAC, we have found that ICFA fees for acquisitions of undercapitalized utilities and for carrying costs related to regional plant were not CIAC.¹³ This still leaves some ICFA fees we view as potentially CIAC. Thus, we turn to the second question – whether the structure of Global Parent provides the Commission certainty as to the tax liability of its members and the taxes actually paid by those members. In Decision No. 70980 (May 5, 2009), we approved Global's application to reorganize from an LLC structure to a corporation –

¹¹ Tr. at 815.

¹² Tr. at 641 (Testimony of William Rigsby for RUCO) Tr. at 819 and 880 (Testimony of Linda Jaress for Staff).

¹³ Of the \$60,084,123 received, we have allocated \$43,871,802 to acquisitions and \$7,539,796.88 to carrying costs – a total of \$51,411,598.88; leaving \$8,672,524.12.

upon completion of that reorganization, Global's tax structure will be more in line with other utility holding companies. The ICFA revenues will however continue to be subject to tax liability and therefore we will address our general position on the tax consequences of ICFA revenues as it would relate to any corporate structure.

We agree with WUAA, that taxes paid to the government on ICFA fees do not go into rate base. Irrespective of the corporate structure, as Global continues to receive ICFA fees, it will incur a tax liability and that liability must be recognized. It is appropriate, then, to deduct the tax liability associated with ICFA funds prior to any potential CIAC imputation.

In this case, the record shows the \$24,057,683 was distributed to the members of Global Parent for tax liability and as WUAA points out it could not have been used for plant.

d. ICFA Summary

We find that ICFAs can provide the necessary incentives and funding to achieve the Commission's goals for consolidation of undercapitalized utilities and regionalized plant that allow for sustainability. We find that ICFAs generate a tax liability regardless of the corporate structure and that liability must be recognized. We find that funds received from developers must be considered CIAC if they are used to construct utility plant. We find that funds received from a developer that are employed for consolidation of undercapitalized utilities and carrying costs of regional plant should not be treated as CIAC.

We have developed the following principles to assess ICFA-style revenue:

1. ICFA revenue used to construct utility plant will be considered CIAC.
2. Only after-tax ICFA revenue will be considered as potential CIAC.
3. All after-tax ICFA revenue will be treated as CIAC unless it is offset by:
 - a. the carrying costs associated with regional plant used for Total Water Management; and/or
 - b. the cost of purchasing undercapitalized utilities.

In the case of acquisitions, the following additional criteria apply:

1. The use of developer funds for an acquisition shall preclude any application for an acquisition adjustment.
2. The buyer must own and operate one or more utilities with more customers, more revenue, and more plant-in-service than the acquired company, thus providing an increase in technical, managerial and financial capabilities for the acquired company.

3. The acquisition must be part of a regional plan of consolidation and conservation – it is not our intent to encourage ‘cherry-picking’ of already healthy systems, rather it is to provide a tool that allows a fair price to be paid while protecting ratepayers from paying for the cost of growth, and which leads to more effective regional water resource planning and conservation.
4. The developer(s) shall not exercise control over the utility system, management, or planning as a result of the ICFA.

Although we recognize the ongoing nature of carrying costs, for the purposes of this case we agree with Global that it is reasonable to use the \$7,423,541 in interest payments on the IDA bonds as the carrying cost offset. In future cases the Company will have the burden to demonstrate the appropriateness of its proposed carrying cost offset.

For purposes of this case we find that the \$43,871,802 Global identified as acquisition premiums for which ICFA revenues were used as an offset meet the four criteria for acquisitions specified above. In future rate cases it will be the Company’s burden to demonstrate that ICFA revenues used for acquisition costs meet the four criteria for acquisitions specified above.

The offsets to ICFA revenues are summarized here:

Post-Tax ICFA Revenues	\$36,026,440
Less Carrying Cost of TWM Plant	\$7,844,179
Less Acquisition Costs	\$43,871,802
ICFA Revenues eligible for CIAC treatment	(\$15,689,541)

e. Deferred Recognition

We are deeply concerned by the extraordinary current economic situation, and the significant difficulties ratepayers face today. While we agree with Global that ICFA fees should not be CIAC when they are used to cover the carrying cost of regional plant, used to pay for acquisition premiums, or used to pay taxes, we are reluctant to give immediate effect to our conclusion in light of the current economic situation. Therefore, we will defer recognition of our ruling until the next rate case(s) for the Global Utilities, and adopt the rates recommended in the Recommended Opinion and Order. The Recommended Opinion and Order (at page 17) reduced rate base as follows: \$6,849,397 for WUGT, \$10,323,747 for Palo Verde, and \$6,105,227 for Santa Cruz. Thus, we will authorize the Global Utilities to make accounting entries to reverse these reductions on a going-forward basis. We also recognize the inherent problems of negative rate base and thus authorize Global to reset the rate base of WUGUT immediately to zero. Resetting WUGT’s rate base to zero will have no impact on rates (because rates for WUGT are set on an operating margin) and will avoid the significant problems associated with a

negative rate base. Accordingly, we authorize the Global Utilities to make the following accounting entries:

- (1) To re-set the rate base of WUGT to \$0;
- (2) For WUGT to record a regulatory asset of \$2,563,849 (The difference between Global's proposed rate base and zero);
- (3) For Santa Cruz to record a regulatory asset of \$6,105,227;
- (4) For Palo Verde to record a regulatory asset of \$10,323,747;
- (5) To continue to record the Southwest Plant (\$32,391,318) as CWIP and not CIAC; and
- (6) To make such other entries as are necessary to reverse the adjustments shown on Exhibit B hereto, entitled "Calculation of ICFA Rate Base Adjustments"

In addition, we direct the Global Utilities to record future after-tax ICFA fees as CIAC except where those fees are used to cover the carrying cost of regional plant, or used to pay for acquisition costs.

INSERT at page 82, line 17, a new Findings of Fact, as follows:

84. It is reasonable to defer recognition of our rulings regarding ICFAs until the next rate case(s) for the Global Utilities. Accordingly, it is reasonable to approve an accounting order authorizing the Global Utilities to make the following accounting entries:

- (1) To re-set the rate base of WUGT to \$0;
- (2) For WUGT to record a regulatory asset of \$2,899,495
2,563,849 (The difference between Global's proposed rate base and zero);
- (3) For Santa Cruz to record a regulatory asset of \$6,105,227;
- (4) For Palo Verde to record a regulatory asset of \$10,323,747;
- (5) To continue to record the Southwest Plant (\$32,391,318) as CWIP and not CIAC; and
- (6) To make such other entries as are necessary to reverse the adjustments shown on Exhibit B hereto, entitled "Calculation of ICFA Rate Base Adjustments"

85. It is reasonable to require Global Utilities to record future after-tax ICFA fees as CIAC except where those fees are used to cover the carrying cost of regional plant, or used to pay for acquisition costs.

INSERT at page 86, line 16, the following additional Ordering Paragraphs:

IT IS FURTHER ORDERED that the Global Utilities shall make the following accounting entries:

- (1) To re-set the rate base of WUGT to \$0;
- (2) For WUGT to record a regulatory asset of 2,563,849 (The difference between Global's proposed rate base and zero);
- (3) For Santa Cruz to record a regulatory asset of \$6,105,227;
- (4) For Palo Verde to record a regulatory asset of \$10,323,747;
- (5) To continue to record the Southwest Plant (\$32,391,318) as CWIP and not CIAC; and
- (6) To make such other entries as are necessary to reverse the adjustments shown on Exhibit B hereto, entitled "Calculation of ICFA Rate Base Adjustments"

IT IS FURTHER ORDERED that the Global Utilities shall record future after-tax ICFA fees as CIAC except where those fees are used to cover the carrying cost of regional plant, or used to pay for acquisition costs.

MAKE ALL CONFORMING CHANGES

Exhibit

"3"

Exhibit 3

Proposed Amendment – Recycled Water and Non-Potable Water Phase-In

PAGE 65, LINE 19, INSERT a new paragraph after “and adopt it.” as follows:

The Applicants also propose that Palo Verde’s recycled water rate and Santa Cruz’ non-potable water rate be phased-in over five years. This phase-in will allow large users such as homeowners associations to adjust their use. As with the other phase-in, the foregone revenue will not be recovered. No party opposed this proposal, and we will adopt it.

MAKE ALL CONFORMING CHANGES