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BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES CHAIRMAN	SANDRA D. KENNEDY COMMISSIONER	PAUL NEWMAN COMMISSIONER
GARY PIERCE COMMISSIONER	BOB STUMP COMMISSIONER	

IN THE MATTER OF THE COMMISSION'S GENERIC EVALUATION OF THE REGULATORY IMPACTS FROM THE USE OF NON-TRADITIONAL FINANCING ARRANGEMENTS BY WATER UTILITIES AND THEIR AFFILIATES.	**DOCKET NO. W-00000C-06-0149** **CITY OF MARICOPA'S PRE-WORKSHOP MEMORANDUM**

RESPECTFULLY SUBMITTED this 29th day of October, 2010.

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This Memorandum is filed on behalf of the City of Maricopa (the "City") in response to the request included in Staff's Memorandum filed October 15, 2010, in the above referenced Docket. The following Memorandum outlines several problems with the Infrastructure Coordination and Financing Agreements ("ICFA") that Global Utilities ("Global") have utilized and concludes that ICFAs should not, absent substantial changes, be permitted in the State of Arizona. The City looks forward to discussing these issues more thoroughly at the workshop on November 1, 2010.

In addition, the City wishes to express its gratitude to the Commission for providing this opportunity to explore this issue in greater detail. The City recognizes that there are several complicated and competing interests that the Commission must balance when analyzing these issues and, while the City does not believe the ICFA scheme is the right for Arizona, the City is willing to work with stakeholders and the Commission to support a solution that makes sense for the utilities and the ratepayers.

Problems with Current ICFA Agreements

There are several problems with the ICFA Agreements that Global has used and the following section provides an outline of these issues. It should be noted that to the City's knowledge Global is the only utility that has thus far attempted to utilize the ICFA and as a result many of the City's comments are directed at Global but are applicable to any utility that would utilize an ICFA in the future:

1. <u>ICFAs allow utilities to earn a rate of return on developer contributed money which hurts ratepayers.</u>

Utilities in Arizona are not permitted to earn a rate of return on developer contributed funds or what could otherwise be called "free money" because that would require ratepayers to pay twice for the same infrastructure (once to the developer to cover its development costs and then again to the utility to cover its rate of return). At its absolute core, the ICFA scheme is a mechanism that Global developed that gives the utility the ability to collect developer money (free money) and spend that developer money for the benefit of Global while earning a rate of return on that money. The result of this scheme is that ratepayers end up paying twice for the same infrastructure. This scheme is fundamentally at odds with rate making principles, is bad for rate payers, and should not be allowed.

Global's response to the assertion that it is earning a return on free money is to say that it is not technically spending the ICFA funds on plant but rather that it is using different money on plant and it is that different money on which it is technically earning a rate of return. The utility is asking that it be permitted to take in $1.00 of free developer money and put it in the left pocket and then pull $1.00 of its own money out of the right pocket and earn a return on that right-pocket dollar. This trick cannot justify the utility earning a rate of return on the money collected from developers under an ICFA and still leaves the ratepayer paying twice for the same infrastructure.

If this were allowed then any utility with any access to debt or equity would book its income from developers under an ICFA while turning around and providing infrastructure to the developer with its own money. In so doing the utility would still get the same money from the developer but would then be able to earn a rate of return on the money collected. There is no rational reason why every utility would not do business in this manner resulting in more expensive utility rates all over the State; simply a bad deal for ratepayers.

2. <u>The ICFA Agreements are not uniform and treat similarly situated property owners differently.</u>

In the recently concluded Global rate case it was clear that Global utilized several different forms for its ICFA agreements and, in fact, no two agreements entered into evidence in that matter were alike in their terms or their fee calculations. A monopoly provider of essential public services simply should not be allowed to negotiate separate terms with similarly situated neighboring property owners.

3. <u>The use of ICFAs encourages overbuilding of infrastructure turning the utility into a real estate speculator.</u>

In the Maricopa area in particular, the ICFA scheme has resulted in significant and harmful overbuilding of infrastructure in advance of development. Global is apt to argue that developers should not be involved in planning and paying for regional infrastructure and that it is the utilities that should be in full control of developing key infrastructure. The City does not object to the utility having extensive and important input in the planning and design of key infrastructure, however, no party is better suited to know when development of infrastructure is appropriate than the developers of the land that needs the infrastructure. The ICFA scheme effectively removes the land developer/homebuilder from the infrastructure development process and turns the utility into a type of real estate speculator.

Nowhere is this more evident than in Global's construction of the $35 million unused Southwest Plant located southwest of the City of Maricopa. This entire regional plant was constructed to serve a region that altogether failed to develop following the crash in the real estate market. Now, as Global testified during its rate case, Global is stuck paying carrying costs of approximately $8 million per year for a massive plant that is neither used nor useful. It is reasonable to believe that these massive carrying costs could threaten the financial viability or at least the financial health of Global and have a deleterious impact on its ability to serve ratepayers. Had regular developer contributions been required to fund construction of the Southwest Plant it is very likely that the plant would not have been constructed and even if the plant was constructed it would have been done by developers and would not now be a burden on the utility.

The relationship between the developer and the utility that the ICFA creates is one that encourages the developer to encourage the utility to build infrastructure too early. Under the ICFAs the bulk of the fees due to the utility from the developer are not due until the developer has reached final plat and begins to pull building permits. There is little risk to the developer, or "little skin in the game," until the developer is ready to actually move forward with its development. At that point, however, the utility has (as evidenced in the case of the Southwest Plant) already spent the money on constructing facilities. It is in the developer's interest to encourage the building of the utility infrastructure as early as possible so that such infrastructure is in place whenever the developer decides the time to develop is right. This interest is at odds with the utility's interest in making sound business decisions.

Under such circumstances the utility has to listen to the developers who will no doubt be encouraging immediate construction of infrastructure or the utility must somehow step into the shoes of the developer to try and time the market. Under standard procedures developers in need of significant plant construction would be much more likely to carefully time construction and expenditures so as not to overbuild or build too early. A developer will not want to get caught having spent millions on a useless plant. It is much easier for a developer to encourage the utility to build plant right away then to put up its own money to construct that same infrastructure. The ICFA scheme promotes this unhealthy relationship and puts too great a burden on the utility to try and play real estate speculator.

4. <u>The use of ICFA funding shifts the risk of economic slowdown away from the developer and onto the utility.</u>

Under the typical development scenario a developer, and not the utility, is supplying the money or constructing the infrastructure to serve its own development. In this scenario if the development fails to come to fruition for any reason then it is the developer that loses the money it spent on the unused plant and the developer who suffers. This insulates the utility and its many ratepayers from the negative impact of failed development. The ICFA scheme flips this dynamic on its head and has the utility building infrastructure ahead of development with no safety net if the development should fail to get off the ground. This leaves the utility and ultimately the utility's ratepayers at risk of financial harm resulting from a developer's bad bet.

Minimum Requirements if ICFAs are to be Permitted

If the Commission ultimately decides to allow ICFAs the City suggests that several requirements be placed on the ICFAs to limit the actual or potential negative impact to ratepayers.

1. <u>All ICFA money must be spent for the benefit of the property owner paying the money.</u>

ICFA money collected from a landowner must be spent for the benefit of that landowner. In its rate case, Global argued that certain landowners entered into ICFAs with Global to facilitate and provide funds for Global's purchase of a smaller utility company to serve that owner's land. Unfortunately, Global also indicated that ICFA money collected from a landowner in the Maricopa area could easily have been spent to acquire a small utility in the West Valley fifty miles away to serve a different landowner. This is unacceptable because when the Maricopa area landowner ultimately builds and sells homes, the price of the homes will reflect in part the amount of the ICFA payment made to the utility. It is unfair to have ratepayers paying more to acquire a home because the home's developer was required to make a payment to facilitate the utility's acquisition of a small utility across town. There needs to be a nexus between the money provided through an ICFA and some benefit derived by the landowner paying that money. If there is no such nexus then the ICFA should not be an option.

2. <u>All ICFAs must include standardized terms and prices for similarly situated customers.</u>

The ICFAs must be standardized and must treat like property owners the same. This will avoid a situation where neighbors have dramatically different agreements with the same utility service provider for the same services.

3. <u>All ICFA funds received must be segregated in a separate account from the moment they are received.</u>

It is essential that all ICFA funds be segregated in a separate account and not comingled with the utility's other money. If the money is segregated it will be possible to track the actual cost free money provided and it will be possible to follow the funds from the developer until spent. Without such a mechanism in place it is impossible to tell where ICFA money is spent.

4. <u>ICFAs must not be required from landowners and traditional financing must be an option.</u>

The developer requesting service from the utility should have the option of whether or not to enter into an ICFA.

5. <u>If payments made under an ICFA are in lieu of payments for hookup fees and other infrastructure costs then such payments must be deducted from rate base.</u>

If the ICFA payments are in place of any further infrastructure costs to the developer then the amount of the ICFA payment must be deducted from rate base no matter where the money is spent. Many of Global's ICFAs entered into evidence in its rate case included provisions indicating that the landowner would not be responsible for any future charges in excess of the amount paid under the ICFA. In other words, the ICFA payments were payments in exchange for the installation of infrastructure or plant. In this case, even if the ICFA funds are segregated in a separate account from the beginning those funds are still collected in exchange for plant and a rate of return on that money cannot be granted.

If the payment made under the ICFA is in lieu of other payments for infrastructure then the developer's ICFA money used to buy the small utility and the acquiring utility's money spent on the installation of infrastructure are really indistinguishable. The following example is an illustration of this point:

> Landowner is currently served by Small Utility and is not happy with Small Utility. Landowner asks Big Utility to acquire Small Utility and Landowner gives Big Utility $1 million under an ICFA to help purchase Small Utility. After purchasing Small Utility for $1 million, Big Utility then goes and installs $1 million of infrastructure to serve Landowner at no charge to Landowner. Big Utility will argue that it spent Landowner's

> money on the acquisition of Small Utility and its own money on the construction of the infrastructure entitling Big Utility to earn a rate of return on the $1 million. The bottom line is that Landowner paid $1 million and in exchange received service and infrastructure from Big Utility at no further cost. There is no justification for Big Utility to earn a rate of return on the $1 million of infrastructure it built in exchange for $1 million from the Landowner.

The forgoing example illustrates how absurd it would be to allow the rate basing of ICFA funds when the deal is structured as a payment in lieu of additional fees.

Conclusion

The City of Maricopa believes there are fundamental problems with the ICFA arrangement that lead to increased costs for ratepayers and increased risks for utilities. Ultimately, the ICFA appears clearly to have been designed as a tool for a utility to attempt to earn a rate of return off of free money while continuing to grow its utility business. The City recognizes that there are real challenges in solving problems related to the need for consolidation of smaller utilities, however, ICFAs and the increased costs to ratepayers are not the solution.

Original plus 13 copies of the foregoing filed this 14th day of October 2010, with:

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