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BEFORE THE ARIZONA CORPORATION COMMISSION

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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

RESIDENTIAL UTILITY CONSUMER OFFICE'S COMMENTS

The Residential Utility Consumer Office ("RUCO") RUCO submits these comments for review and discussion by the Commission and all interested parties regarding the appropriate accounting treatment of Infrastructure Coordination and Financing Agreements ("ICFAs").

OVERVIEW

In the recent *Global Utilities* rate application, over the strong objection of the utility, the Commission held that ICFAs constitute non-investor supplied capital and must be booked as CIAC. Decision No. 71878 described ICFAs as follows:

> "ICFAs formalize the cooperation between the landowner and Global, but also provide fees which allow Global Parent to impress conservation and consolidation into the regional planning initiatives. These fees are intended to recover a portion of the carrying costs for the very expensive facilities required to implement effective water conservation and, in some cases, to fund Global Parent's acquisition of existing utilities." (Order at p. 12)

The Commission noted that the goals of total water management and acquisition of struggling water companies are "laudable". RUCO wholeheartedly agrees. Yet, RUCO also agrees with Staff's position that these goals can be achieved through other means, including traditional ratemaking mechanisms. (Id. at p. 16).

Historically, non-investor supplied funds came from main line extension agreements or from hook up fees. Third party developers provided funds to utilities for the purpose of receiving water utility service. Those funds were properly booked as CIAC or AIAC and treated as a deduction from rate base.

Now, the Commission is being asked to consider ICFAs as a brand new form of third party cash that deserves different accounting treatment. The claim is that ICFA funds are not being used for normal rate base assets but are for more lofty and conceptual (but no less important) goals of water conservation, healthy water utility management and operations and the acquisition of troubled water companies.

SUMMARY

RUCO remains suspicious that any developer would provide funds for purposes other than the ultimate goal of providing plant to service their development. As the Commission recognized in its Decision, "Staff submits that it does not seem reasonable to assume that developers paid Global Parent millions of dollars, not for plant, but as a sort of donation to insure that the Global Parent members receive a return on non rate-based plant and amounts sufficient to pay taxes on the return." (p. 17)

RUCO was not persuaded by the utility's claim that if the Commission does not treat ICFAs as revenue there will be no effort toward "total water management" or to acquire small water companies. (Id. at 13,15) RUCO believes that the Commission and its Staff should not be bullied by such thinly veiled threats. Furthermore, RUCO believes that in addition to traditional ratemaking mechanisms, there are other options available for the Commission to incent the industry to acquire troubled water companies.

RUCO is interested in hearing more from the industry during these workshops regarding the specific details of its proposal to segregate and separately account for ICFA funds as well as the possible uses for these monies that would then, in turn, be treated as revenues for ratemaking purposes. RUCO will participate in these workshops with an open mind to consider what the industry proposes.

FUNGIBLE NATURE OF CASH / SEGREGATION OF ICFA FUNDS

A primary obstacle for the Commission in Decision no. 71878 was that utility's parent commingled monies obtained through ICFAs with other monies. The ALJ made it clear that there was no easily traceable trail confirming the utility's claim that the ICFA funds were not used for plant. At Open Meeting, there was much discussion whether maintaining segregated accounts for ICFA funds and providing detailed accounting for the use of the ICFA monies would provide sufficient transparency and allow the Commission, Staff, RUCO and other interested parties the ability to "follow the money."

If the Commission finds that the fungible nature of cash is a fact that simply cannot be overridden, then ICFAs cannot be given rate base treatment even if the funds are segregated and separately accounted. Thus, since cash is fungible, the utility can re-direct the ICFA funds to non-rate base expenses in order to free up investor supplied capital for plant.

The fungible nature of cash is a concern that should not be easily dismissed. At stake is allowing utilities to earn a rate of return on investments that were made possible because a third party, not the utility, provided funds for other utility expenses. A regulator provides a reasonable rate of return to a utility because the utility took the risk of using its own funds. But with ICFAs, that risk is mitigated if not eliminated.

The concern of the fungible nature of ICFA revenues can only be resolved if the Commission is able to find that the ICFA funds are sufficiently attenuated from the investor-supplied funds. If so, then, ***at a minimum***, a utility must completely segregate monies received by ICFAs and provide documentation regarding the use of those monies.

QUESTIONS POSED FOR THE WORKSHOP

1. Whether ICFAs or other mechanisms, if properly segregated and accounted for, could be utilized to finance the actual acquisition of troubled water companies.

RUCO has testified in several rate cases that all residents of Arizona deserve safe, clean and reliable drinking water.[1] Yet, many Arizonans receive their water service from troubled water companies that are out of compliance with ADEQ and/or Commission standards. RUCO maintains that it is in the public interest for financially healthy and efficiently operated water companies to acquire troubled and struggling companies.

RUCO is interested in reviewing the industry's proposal how ICFAs could encourage the acquisition of these companies. RUCO expects the industry to provide a detailed road map on how these funds would be used and why this is a preferred method of acquisition over other mechanisms.

2. Whether ICFAs, if properly segregated and accounted for, would be appropriate for use in covering such expenses as a portion of the carrying costs associated with unused regional water and wastewater facilities or infrastructure.

In Decision No. 71878 Global noted that "if ICFA fees are treated as CIAC as recommended by RUCO and Staff, Global Parent will be unable to continue its commitment to total water management, which entails significant carrying costs." (Id. at 13)

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[1] Arizona Water, Docket No. W-014457A-08-0440; Bella Vista, Docket No. W-02465A-09-0411, Arizona-American, Docket W-01303A-09-0343 No. Rate Consolidation Testimony of Jodi Jerich.

A utility incurs carrying costs when it provides investor-supplied capital or issues debt to pay for infrastructure. Carrying costs accrue between the time the utility makes the investment until it can recover its investment through a Commission-authorized increase in rates. However, if a third party is providing the funds for the infrastructure, ***then the utility has no carrying costs***.

RUCO is interested in participating in the workshops to gain a better understanding of the industry's claim that treating ICFA fees as CIAC will hinder its ability to meet total water management goals due to significant carrying costs.

3. Whether other mechanisms not addressed in the Global case would be appropriate in inducing such regional water and wastewater infrastructure, and the acquisition of troubled water companies, such as acquisition adjustments, rate premiums, or Distribution System Investment Changes.

RUCO finds that other mechanisms can provide appropriate rate relief for companies to provide state of the art infrastructure as well as incentives to acquire troubled water companies. This workshop is an appropriate forum to review the 2001 Staff Memorandum regarding the recovery of acquisition costs for small water companies through (1) acquisition premiums or (2) rate of return adjustments. Additionally, this workshop can continue the discussion from the Arizona Water, Bella Vista and Arizona-American rate cases on how rate consolidation can provide an incentive to acquire water companies. Finally, at the Open Meeting where the Commission debated *Global Utilities*, there was discussion whether a company should seek pre-approval for the accounting treatment of ICFA funds. This is also another possible solution that could be discussed in these workshops.

RESPECTFULLY SUBMITTED this 29th day of October, 2010.

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