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ARIZONA CORPORATION COMMISSION
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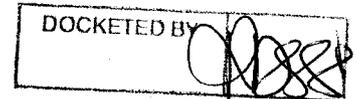
December 17, 2010

Arizona Corporation Commission

DOCKETED

JAN 4 2011

Commissioner Sandra Kennedy
Arizona Corporation Commission
1200 West Washington
Phoenix AZ 85007-2996



Dear Commissioner Kennedy:

- ACC-00000A-10-0466

Thank you for sharing your concerns about the time required to process rate cases. It is a major concern for us as well. Resource limitations are impacting all of us and the pressure to get the job done continues to increase. Streamlining the rate case process is important as it helps all of us to reduce staff needs, reduce substantial expenditures on rate case preparation, and helps in timely application of rate tariffs to ensure the financial viability of our water companies.

Community Water's mission is to reliably deliver drinking water to our customers (that meets all regulated standards) and to maintain a sustainable water supply for our customers. A sustainable water supply also requires that Community Water be financially sustainable. We are a cooperative with about 10,000 members (serving about 22,000 people) who entrust management to carry out our mission. Our members elect nine of their fellow members to serve on the Board of Directors of Community Water for a three year term. The Board of Directors is accountable to our members for guidance and review of management's efforts in running the company to meet our members' needs. Community Water has always been pro-active in communication with our members/customers. As an example, management organized several member meetings to discuss our most recent rate case applications. A handful of members showed up for each of these meetings. The members attending these meetings did not express concern about the proposed rate increases.

Our impression is that your various options appear directed at approving some portion of a rate case in a shorter time. While spreading the rate case workload over a longer period of time, the options don't appear to reduce the total workload required by any of our staffs. The net effect of this is likely to reduce the frequency with which the water companies can file future required rate cases. In a stable regulatory environment, both financially and environmentally, that might be acceptable. But based on the trends of the past several years, reducing

the frequency of access to rate case submittals is probably contra-productive to developing financial sustainable water companies in Arizona.

The rate approval authority that the ACC is responsible for can be accomplished in several ways. A non-productive approach to fulfilling this responsibility is illustrated by your letter's reference regarding a statement at a Commission workshop suggesting that a refund to customers that were "overcharged" by a water company as the result of following a prescribed rate application process should be 3 to 5 times the over collection. A productive approach is to recognize the shared goals between our customers, the water companies, and the ACC, and have the ACC provide leadership in establishing a rule set for monitoring acceptable rate design by the various water companies subject to ACC regulation.

The water companies are responsible for delivering water that meets regulatory standards, implementing rates that ensure long term financial sustainability, and implementing plans for the long-term water sustainability. Our customers are entitled to the benefits of these responsibilities, but do have an obligation to pay the full costs incurred to provide these benefits.

A key measure of the financial performance of a water company is the rate of return it can generate on the total plant employed to deliver water. Rate of return is defined as earnings plus interest payments and income tax payments divided by the total plant employed. Today's financial market place requires that the water companies earn a rate of return at least equal to the cost of borrowing capital to finance the total plant utilized to deliver water. This would suggest a rate of return in the seven to nine percent range on total plant utilized to deliver water.

The ACC should adopt a rate approval approach whereby the individual water companies establish their rates adhering to ACC published guidelines. This is similar to a "tax law" concept. The IRS publishes tax regulations and the individual companies determine the appropriate manner to complete their tax filings and pay the taxes owed. The IRS reserves the right to select and audit returns to ensure ongoing compliance with the regulations. The delivery of water, and setting the associated water tariffs, is certainly less complex than the existing U.S. Tax Code.

Under the present ACC rate case process, management is limited in its options to develop and implement plans that require outside financing. Community Water has had numerous discussions with banks in recent years relative to financing. A clear message that was given to us was that rate case applications

have no guarantee in the banks' eyes until the Commission formally approves them. Revenues collected from interim rates would be excluded from satisfying bank lending criteria as the ACC could deny the rate increase in its entirety and require refunds months after revenues were collected. This reinforces the concept that the water companies have to have strong financials to conduct their regular business based on rates being charged at any point in time, otherwise access to capital is limited until an ACC loan application is approved, and probably an accompanying rate case application is approved. Borrowing arrangements would be further complicated if the risk of penalties due to rate denials are added into the mix for companies seeking rate increases.

We believe the ACC should consider doing high level reviews with water company rate case submittals. Monitoring of rates would require the establishment of applicable criteria for evaluating whether or not a particular rate case submittal is acceptable; an easy to understand measurement of reasonableness. Setting a target rate of return of seven to nine percent would be the first screen for a water company rate submittal. A second screen would be to develop a database of total plant facilities utilized per customer for the entire population of water companies subject to ACC jurisdiction. Those companies that fell outside of the two sigma deviations from the average plant dollars per customer utilized to deliver water would be subject to review, (i.e. a rate case submittal audit) and could result in possible ACC intervention.

The ACC should also develop financial guarantees to banks that provide lower cost loans to water companies. Then, if the financial condition of the water company meets the lending requirements of the particular bank, the bank would make the requested loan to the applicant water company. In the case of default, the ACC loan guarantee would kick in. The ACC would also arrange a low cost funding source, such as WIFA, to provide funding to water companies that could not qualify for the low cost bank loans provided by the private banks. Access to this funding source would be accessible only to those companies that were subject to rate audits.

Additional factors would be included in the ACC monitoring of water company rates. Presented below are other factors the ACC could use to determine whether or not a rate case submittal required audit. The ACC and its staff would then focus on those submittals that it determined required audit.

- The regulated water company received an unqualified opinion on all its financial statements since the previous rate case.

- The ACC Utility Annual Report is submitted timely and the company explained financial differences to the prior year on the report and the changes appear acceptable to a rate case auditor.
- The company does not have any outstanding compliance issue pending with any regulatory agencies.
- The company has a low complaint level.
- The company's communication efforts with its customers/members are strong.

If a company's rate case submittal does not require an audit based on ACC published criteria, the proposed rate tariff would be approved as submitted. The Commission would focus its attention on the rate case submittals requiring audit.

Thank you for your interest in reviewing our input on this important issue. Please contact us should you have any questions on our comments and recommendations.

Sincerely,



Arturo Gabaldon
President

Attachment:

ACC Commissioner Sandra Kennedy letter to Community Water Gabaldón, dated November 18, 2010.

cc: Kristine K. Mayes, Chairman
Paul Newman, Commissioner
Gary Pierce, Commissioner
Bob Stump, Commissioner
Brenda Burns , Commissioner Elect
Ernest G. Johnson
Janice Alward
Steven Olea
Kennedy Wilder, Public Information Officer