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BRENDA BURNS

IN THE MATTER OF THE COMMISSION'S GENERIC EVALUATION OF THE REGULATORY IMPACT FROM THE USE OF NON-TRADITIONAL FINANCING ARRANGEMENTS BY WATER UTILITIES AND THEIR AFFILIATES

Docket No. W-00000C-06-0149

NOTICE OF FILING

The Global Utilities[1] file the following documents that were presented at, or prepared for, the June 24, 2011 workshop in this docket:

(1) "Preparing for Growth", Paul Walker, Arizona Insight, LLC

(2) "Global Water's Mission & ICFAs", Trevor Hill, President & CEO, Global Water Resources, Inc.

(3) "Accounting for Infrastructure Coordination and Financing Agreements", Brett Higginbotham, CPA, Controller, Global Water Resources, Inc.

(4) "Using Developer Money to Pay for Acquisitions: Legal and Policy Issues", Timothy J. Sabo, Roshka DeWulf & Patten

(5) "Carrying Costs and ICFAs", Matt Rowell, Desert Mountain Analytical Services

(6) Additional presentation, "Fungibility"

(7) City of Maricopa, City Council Resolution No. 11-40, regarding Infrastructure Coordination and Financing Agreements

(8) Pennsylvania Policy Statement on Acquisitions, 52 Pennsylvania Administrative Code §§ 69.711 and 721

[1] Global Water - Palo Verde Utilities Company, Global Water – Santa Cruz Water Company; Hassayampa Utility Company, Inc., CP Water Company, Global Water– Picacho Cove Utilities Company, Global Water – Picacho Cove Water Company, Valencia Water Company – Town Division, Valencia Water Company – Greater Buckeye Division, Water Utility of Greater Tonopah, Inc., Willow Valley Water Co., Inc. Water Utility of Northern Scottsdale, Inc. and Balterra Sewer Corp.

RESPECTFULLY SUBMITTED this 22nd day of July 2011.

Roshka DeWulf & Patten, PLC

By Timothy J. Sabo

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Original + 13 copies of the foregoing filed this 22nd day of July 2011, with:

Docket Control
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Attachment

"1"

Preparing for Growth

Insight Consulting, LLC

1

Arizona Corporation
Commission
Water Finance Workshop
Docket No. W-00000C-06-0146
June 24, 2011

WHAT ARE WE TRYING TO ACHIEVE?

1. To facilitate acquisition / consolidation and regional planning. We are not trying to put <u>all</u> costs onto developers:
   A. Global invests in plant and infrastructure,
   B. Global contributes toward acquisitions,
   C. Developers - who benefit from consolidation and regional planning - should contribute to acquisition and carrying costs in ICFA regions.

2. Existing ratepayers should not pay the costs for consolidation and regional planning for new growth.
   A. But they also shouldn't expect shareholders to put millions of dollars into unrecoverable costs.

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6/24/2011

How Did We Get Here?

"ICFA fees are **paid** to Global Parent **by developers** and land-owners who require utility plant and utility service to sell homes, **so it is logical to assume that the fees will be used for that plant.**"

- Jaress Surrebuttal. Page 1, Line 30 through Page 2, Line 1.

ICFA money is from Developers, → Development requires utility service, → Service requires plant. → Ergo, ICFA money is for plant.

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Two Steps to the Staff Conclusion

Step One:

"ICFA fees are paid to Global Parent by developers and land-owners who require utility plant and service to sell homes,"

Step Two:

"so it is logical to assume that the fees will be used for that plant."

Results:

- All developer-provided funds are CIAC.
  - $85 million operating loss for Global in 2010,
  - $43 million in acquisition costs ignored,
  - $59 million of assets deemed CIAC
  - Created negative rate bases in two companies.

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Many Facts, But Only one was chosen

- Step One:
  - "ICFA fees are paid to Global Parent by developers and land-owners who require utility plant and service to sell homes,"

Fact that Was Recognized:

  - Developers care about getting plant and service to sell homes.
- Other Facts:
  - Developers:
    - are not indifferent to the type of plant, to the nature and quality of service, the timing of construction, or the costs they face.
    - know they need integrated providers for ACC approval,
    - know that water-scarce areas decrease density and saleability,
    - know that water reclamation and reuse can solve water scarcity.

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But, the Chosen Fact wasn't Fully understood…

- If developers care <u>only about plant</u>, and they are to provide the funding for that plant:
  - they will only build plant sufficient for their development – without regard to regional issues,
  - they will avoid any costs they cannot recover and will try to recover every cost in their sales.
- Developers in ICFA areas were NOT doing CIAC and AIAC in those areas – but they WERE doing CIAC and AIAC in other areas. Why?
- Because the ICFA service areas had two challenges:
    - **Massive Water Scarcity, and**
    - **Undercapitalized Utilities in the Path of Growth.**

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What Really Led to ICFAs

ICFA Drivers

- Acquisitions of large service areas
- Need for TWM-infrastructure to deal with Water Scarcity
  - But, large, regional plant increases carrying costs

ICFA Solutions

- Acquisitions that don't cost ratepayers money, and
- Dealing with Carrying Costs for plant to solve Water Scarcity

Reasons Developers Supported ICFAs

- Sonoran/387 Districts, and West Maricopa Combine had significant operational challenges that reduced developers ability to build and sell homes,
- CP Water had large service area and no history of service.

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Getting the Global Water Ship Onto the Rocks

1. All Acquisition Costs borne by Shareholders – and non-recoverable,
2. All ICFA money assigned to plant – and non-recoverable.

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Acquisitions, Water Scarcity, and ICFAs

Developers needed to consolidate large service areas

- ICFAs were signed in regions that had to overcome large service area rights by existing utilities.

Because, they needed Water Reclamation & Reuse

- ICFAs were signed in areas that faced major water challenges.
  - But: Cave Creek, Willow Valley, and Water Utility of Northern Scottsdale had zero ICFAs.

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The ACC's Decision on Acquisition Costs

Fact:

- Acquisition costs are real costs – but they should not affect rate base.

But:

- The ACC said none of the $43 million in acquisition costs should be tied to ICFAs,
- And since ICFAs resulted in developer getting service,
- The ICFA money was all for plant.

Result:

- $43 million of acquisition costs were assigned to shareholders,
  - $26.5 million of used/useful rate base was called CIAC,
  - $32 million of stranded assets were called CIAC.

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Acquisitions, ICFAs and Rate Base

Why would Shareholders fund Acquisitions?

- No acquisition adjustments,
- No recovery of the cost, and
- If ICFAs are used for acquisition costs, rate base destroyed.

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The Destruction of Rate Base from the CIAC Imputation

Utility	Rate Base Impact	Plant Held for Future Use
WUGT	$(7,085,645)	
Palo Verde	$(10,991,128)	
Palo Verde SW Plant		$(14,449,976)
Santa Cruz	$(6,600,076)	
Santa Cruz SW Plant		$(17,941,342)
Total	$(26,613,954)	$(32,391,318)

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Real Concerns Led to ICFAs

The ACC had created very large CC&N holdings in some undercapitalized utilities – those CC&Ns were created over many decades.

Record high growth was hitting those areas.

Arizona was in an historic three-basin drought: Colorado, Salt, and Verde rivers simultaneously in drought.

The real estate market was hyper-competitive.

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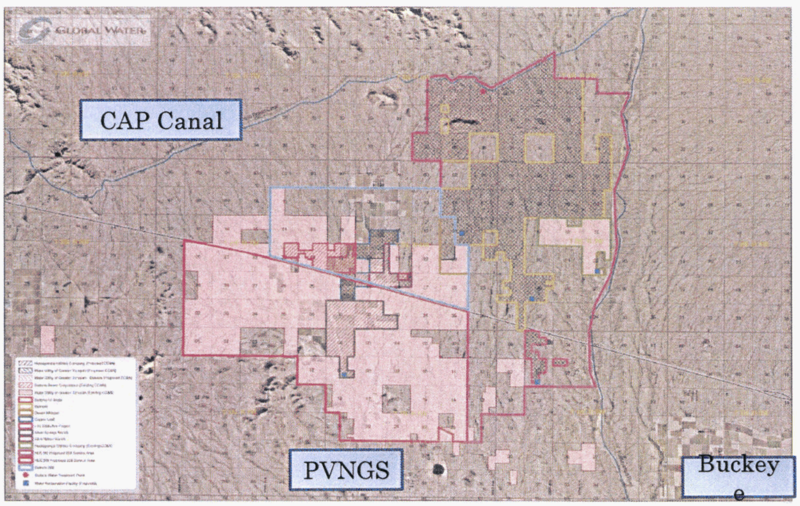
Water Utility of Greater Tonopah CC&Ns
+/- 60 Sections (**1.5 times larger than Tempe**)



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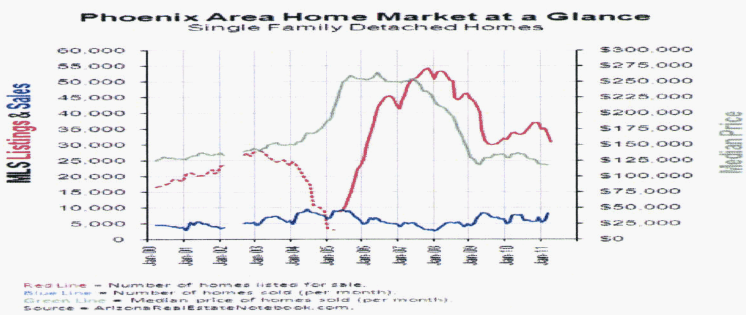
HYPER COMPETITIVE REAL ESTATE MARKETS



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•Record numbers of new homes were hitting the market – and in water scarce parts of the Phoenix & Pinal AMAs,

•Home prices had soared,

•Areas that had no record of managing growth, and that had water challenges, were where ICFAs were signed.

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SOLVING GROWTH & WATER CHALLENGES

Issues	ICFA Solutions
Large CC&Ns in undercapitalized utilities	A way to deal with acquisition premiums
Record High Growth	Ability to coordinate financing costs and timelines
Three-basin drought led to increased ACC and ADWR scrutiny	40% reduction in potable water usage
Hyper-competitive real estate market	Equal status among developments, plant built for regional needs.

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What does Growth Require?

- Density = Profit
  - Requires DAWS, TWM-type utilities, large well-run utility
  - Density also increases ability to reclaim and recycle wastewater
  - Septic-tanks require 1-acre lots; sewer allows 4 homes per acre
- Flexible development timeline
  - Bring homes to market in direct relation to demand:
  - Fast demand-fast development; slow demand-slow development
    - Requires utility that can somehow wear financial risk while investing very large sums into plant that may take years to get into rates. The fundamental issue in Anthem, the Northwest Valley Surface Water Treatment Plant, and Global's "Southwest Area"
- Sophisticated Utility Service Immune from Developer Control
  - Every region has multiple developers with differing timelines, and they are in competition with each other.
    - Requires utility that is indifferent to developer's economic competition and is instead focused on meeting regional demands

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The Real Tests of the ICFA's Public Interest

Actual Uses of ICFA funds:

- Do ICFAs lead to acquisitions?
  - Acquisition costs: Should developers pay those? Should customers? Should shareholders? Who benefits?
- Do ICFAs reduce Carrying Cost risk?
  - Carrying cost risk: Should developers care about how their development affects the region?
    - Does the ACC have a means to address large plant costs like regional surface water plants?
    - How do we serve new communities far from existing infrastructure and sources of water?

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Today's Objectives

Achieve Understanding on:

- Acquisition and Carrying Costs impacts on:
  - Consolidation and Water Conservation,
    - Do ICFAs lead to Consolidation?
    - Do ICFAs lead to Water Conservation?

Explain how ICFAs solve those issues,

- Can other regulatory tools can solve those issues?

Evaluate the ICFA impact on ratepayers:

- **Do ratepayers get shielded from Acquisition and Carrying Costs?**
- **Do their communities get better water planning?**

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What Does Global Want?

1. Get Global Water off the financial rocks.
   A. We need the $26.5 million in used/useful rate base treated as debt/equity-financed plant,
   B. Leave the $32 million stranded assets in the "Southwest Area" out of rate base – and stop calling them CIAC.
2. $43 million in acquisition costs shouldn't reduce rate base.
3. Create a better path – for everyone.
   A. Develop a Pathway for ICFAs:
      i. Lockbox and simple accounting,
      ii. Use developer money for acquisitions,
      iii. Use developer money to minimize carrying costs.

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Attachment

"2"

GLOBAL WATER™
RELIABLE · RENEWABLE · REUSABLE

Global Water's Mission & ICFAs

Trevor Hill
President and CEO

GLOBAL WATER

Water in Arizona

- We believe that water scarcity is a constant challenge in Arizona,
  - Droughts come and go, but water supplies are not increasing.
- Global's service territories in the Phoenix and Pinal AMAs face significant water scarcity constraints.

3

GLOBAL WATER

Why Did Global Use ICFAs?

- **To achieve sustainable growth in water scarce areas**
  - Pinal AMA has renewable groundwater for 144,000 homes,
    - The City of Maricopa Planning Area alone (less than 20% of the County's area) has **325,000** homes in planning,
    - Pinal County has **800,000** homes in planning.

4

GLOBAL WATER

Why Did Global Use ICFAs?

- **Acquiring & Consolidating Challenged Companies**
  - Lots of homes were coming to areas on the fringe, precisely where these companies exist;
  - very little water was available.

5

GLOBAL WATER

Why Did Global Use ICFAs?

- **Allow for partial recovery of carrying costs for regional plant**
  - Regional plant is by definition beyond the realm of the single development;
  - This increases the investment requirement and generates significant carrying costs.

6

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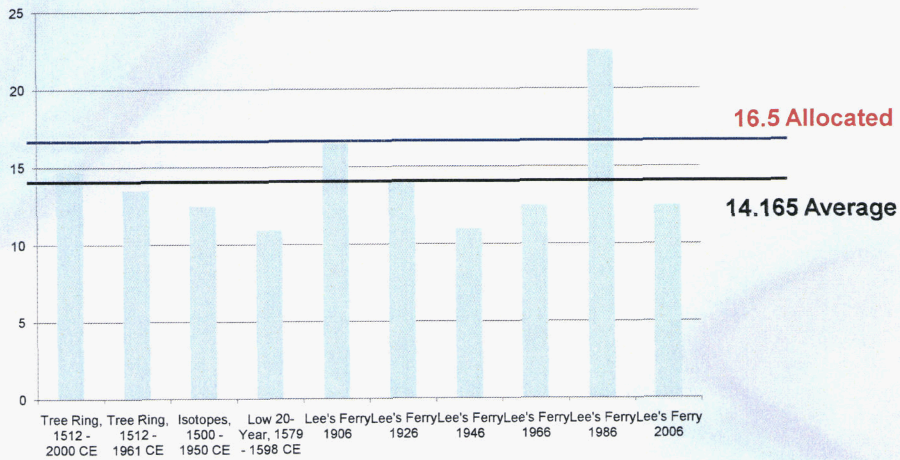
Why Did Global Use ICFAs?

- **Traditional financing techniques simply could not and cannot deal with these issues.**

WATER SCARCITY

Colorado River Flow (MAF)

Actual Flows v. Allocated



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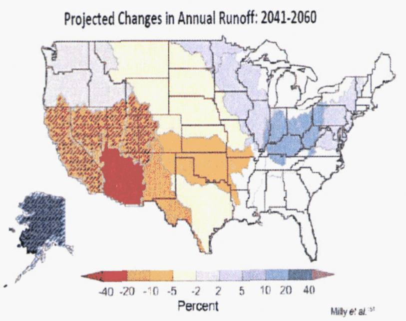
Water is always going to be scarce in Arizona



SOURCE: Draft National Action Plan for PRIORITIES FOR MANAGING FRESHWATER RESOURCES IN A CHANGING CLIMATE.

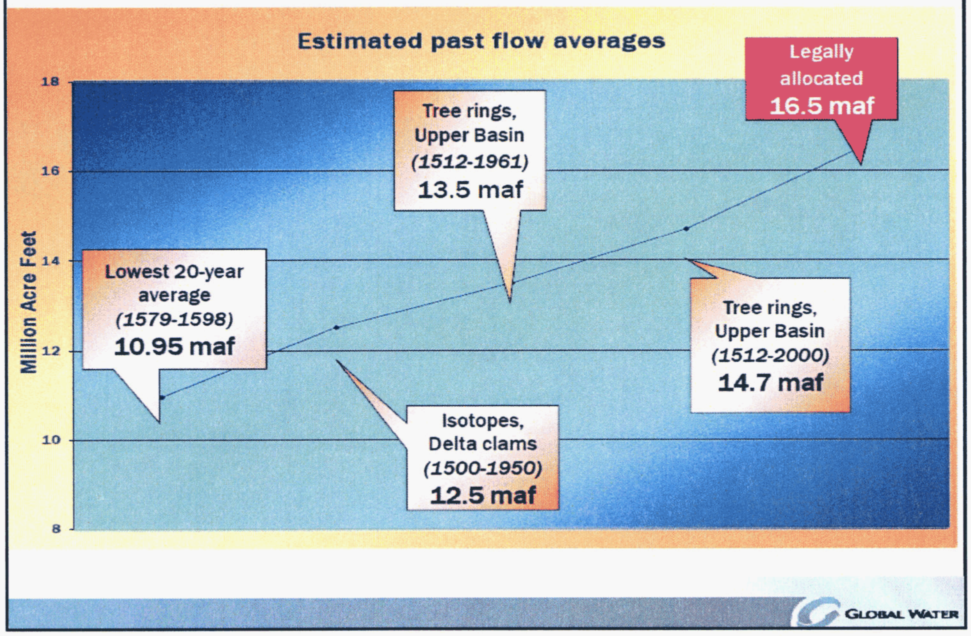
Scripps Institution

- If Colorado River runoff falls "by 10%, scheduled deliveries [of Colorado River water] will be missed 58% of the time by 2050.
- If runoff reduces 20%, they will be missed 88% of the time."

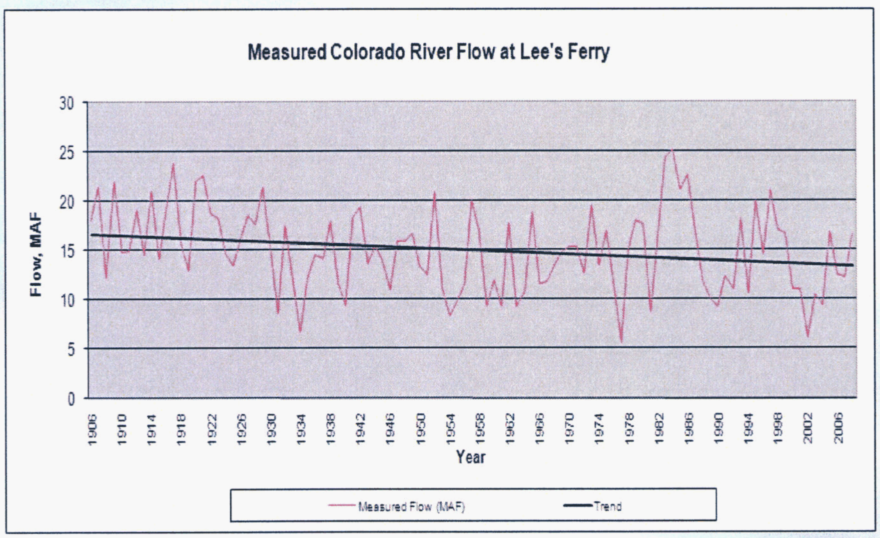
SOURCE: Tim P. Barnett and David W. Pierce
"Sustainable water deliveries from the Colorado River in a changing climate"
Proceedings of the National Academy of Sciences
PNAS May 5, 2009 vol. 106 no. 18 7334-7338.

GLOBAL WATER

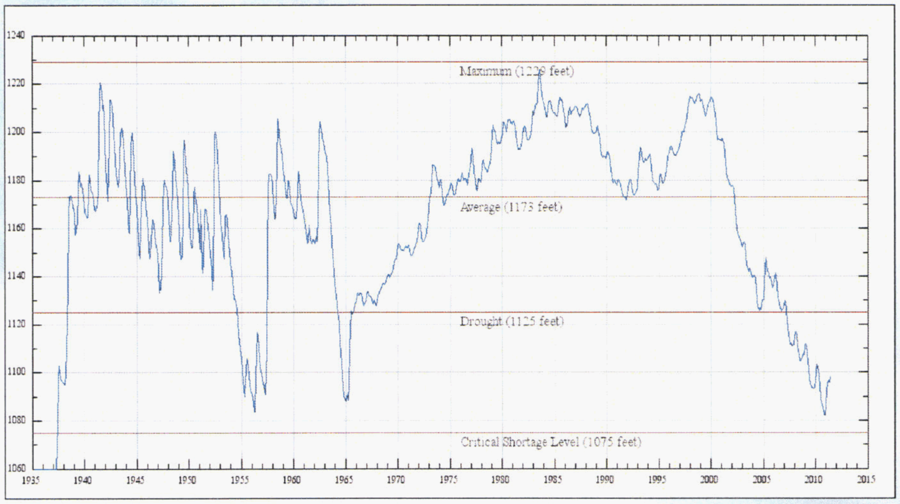
Colorado River Flows



The 100 Year Trend Line – Is Not Good



Lake Mead Levels



US Bureau of Reclamation

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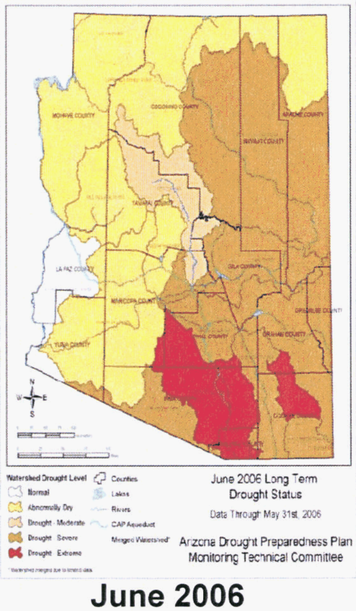
Arizona's Drought Status



June 2006

U.S. Drought Monitor

June 14, 2011
Valid 7 a.m. EST

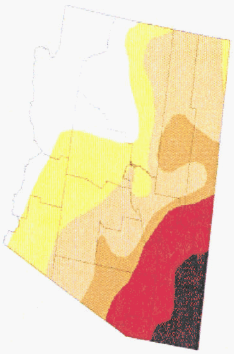
Arizona

Drought Conditions (Percent Area)

	None	D0-D4	D1-D4	D2-D4	D3-D4	D4
Current	22.51	77.49	56.26	28.69	18.27	5.62
Last Week (06/07/2011 map)	22.51	77.49	56.26	28.69	18.34	0.96
3 Months Ago (03/15/2011 map)	28.64	71.36	40.88	12.59	5.96	0.00
Start of Calendar Year (12/28/2010 map)	31.40	68.60	32.45	0.00	0.00	0.00
Start of Water Year (09/28/2010 map)	40.00	60.00	18.58	3.23	0.00	0.00
One Year Ago (06/08/2010 map)	63.87	36.13	14.43	2.66	0.00	0.00

Intensity:

- D0 Abnormally Dry
- D1 Drought - Moderate
- D2 Drought - Severe
- D3 Drought - Extreme
- D4 Drought - Exceptional



The Drought Monitor focuses on broad-scale conditions. Local conditions may vary. See accompanying text summary for forecast statements.

http://drought.unl.edu/dm

Released Thursday, June 16, 2011
Brian Fuchs, National Drought Mitigation Center

June 2011

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GROWTH

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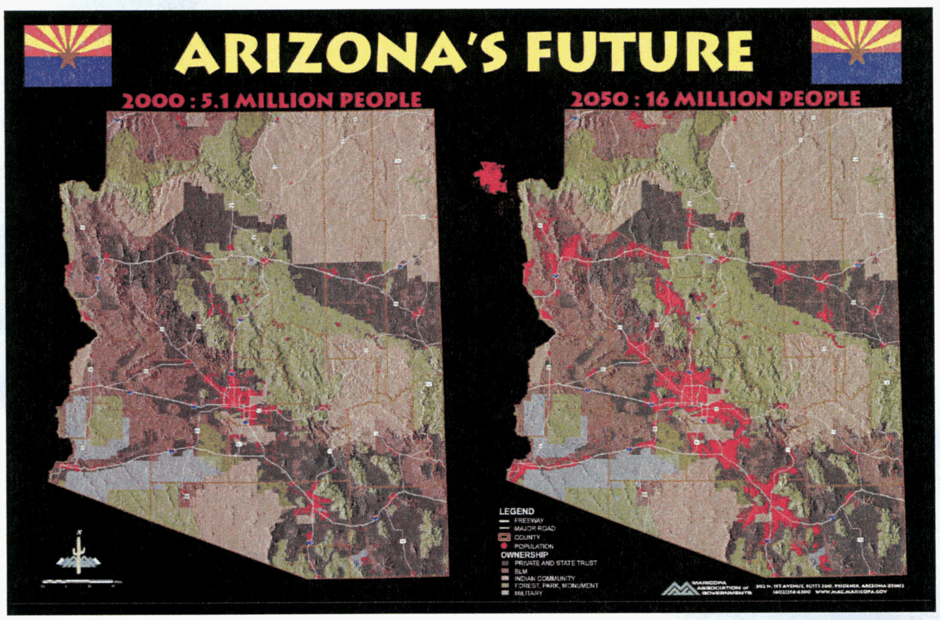

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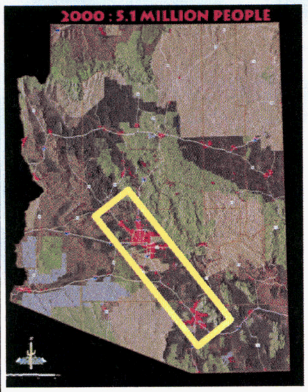
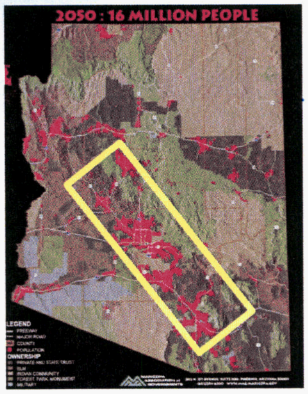
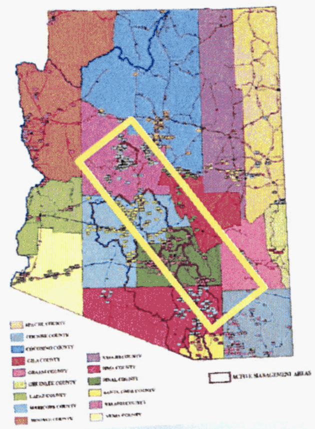
The ACC's Regulatory Corridor







Arizona Population: Year 2000

Arizona Population: Year 2050

ACC Water/Wastewater Utility Map

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GLOBAL WATER

Building Public Support for Water Reuse

Growth is inevitable. Water isn't.

Do some simple math and Arizona's water future will shock you: 5.6 million new people by 2030*, each using an average of 135 gallons a day for a total increase in demand of 756 million gallons of water per day. Where will it all come from? We can either pray for a biblical weather change or get busy making smarter use of our current sources. Global Water is leading the way with a water recycling model that helps new communities consume 40% less fresh water. Recycling is the only water source that grows as our population does. So by 2030, Global could be saving Arizona 300 million gallons of fresh water per day. That's a future we can live with.

To learn more about water recycling, visit us online at www.gwresources.com

GLOBAL WATER

Basic Reuse: + 3.1% cost = 35% water savings

Advanced Reuse: + 26.5% cost = 43% water savings

Water Resource Scenario	No Reclamation	Basic Reclamation	Advanced Reclamation
Water Savings in Gallons/Year/Section	0	96,347,624 35% Savings	116,784,998 43% Savings
Additional EDU's Liberated @ 216 Gallons/EDU	0	1,222	1,481
Capital Cost per EDU	$6,494	$6,694 +3.1%	$8,214 +26.5%

Reclamation & Reuse

Reclamation & reuse require more plant.

- But, retrofitting to reuse is vastly more expensive.

Reclamation & reuse becomes economical with regionally-sized infrastructure.

- Regional solutions require massive collaboration among disparate interests.
- Regional plant increases carrying costs.

Total Water Management

To achieve sustainability, massive investment in water reclamation and reuse are required.

City of Maricopa:

Over 2.6 billion gallons have been reclaimed so far – about 175,000 gallons for each of the 15,000 homes in the area:

- Enough water to provide 2 years of water for each home in City of Maricopa.
- Global's TWM drives water consumption to less than 0.2 acre feet per home per year, compared to the ADWR standard of 0.5 acre feet per home per year.

ACQUISITIONS & CONSOLIDATION

Acquisitions

Acquisitions are very difficult to begin and to complete.

- Post-acquisition issues are at least as hard: Rolling the new company into the organization is costly in time, resources, management focus, and money.

There is **no** successful corporation that treats acquisitions lightly.

Global evaluates 194 items in its standard acquisition process.

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Do ICFAs lead to 'Overvaluation'?

- Neither Global nor the developers entering into the ICFAs have an incentive to overpay.
- Every dollar spent on an acquisition premium is a dollar that could have been used elsewhere.
- The due diligence in a utility acquisition is massive.

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Acquisition Valuations

- **Acquisition prices are negotiated and reflect:**
  - Large service areas,
  - Growth potential, and
  - Employment and income value for owners and their family members.

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How do we know Global did not "overpay" for these utilities?

Global did extensive due diligence prior to purchasing the utilities.

Prior to the rate case Global instituted an efficiency task force that reviewed every dollar of their expenses and resulted in significant expense reductions.

- The suggestion that Global would be indifferent to several million dollars in excess acquisition costs is difficult to accept.

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Purchase Price Issues in Acquisitions

Income & benefits to Current Owners	The price has to exceed Owners' NPV	**Negotiated**
Future growth potential	Within CC&N area & Borderlands	**Negotiated around assumptions**
Water Supply	Surface, Groundwater, and Potential to implement TWM	**Assumptions drive value negotiations**

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ICFA-Supported Acquisitions

- 387 Districts/Sonoran Utilities
- CP Water Company
- West Maricopa Combine
  - Water Utility of Greater Tonopah
  - Water Utility of Greater Buckeye
  - Valencia Water Company
  - Water Utility of Northern Scottsdale
  - Willow Valley Water Company

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Global Water

387 Districts/Sonoran Utilities

Maricopa >10,000 acre service area

- Homes were occupied with no first-world wastewater service
  - Raw sewage was being vaulted & hauled from manholes in the street
- Water was not potable due to high nitrates
  - Nitrates cause 'blue baby syndrome'
- All of Global's $13.4 million in acquisition costs for the 387 Districts/Sonoran Utilities was called "CIAC" and deducted from rate base.

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Global Water

CP Water

West of Casa Grande >1,000 acre service area

- When new service was requested, CP would ask Arizona Water Company to handle it.
  - No employees
  - No water source

- CP Water was developer owned and transferred to Global through the ICFA.

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GLOBAL WATER

West Maricopa Combine

Western & Northern Maricopa County, Mohave County, >50,000 acre service area

- No recycled water plan, no wastewater service in >42,000 acres

- 90% of service area in Lower Hassayampa sub-basin of the Phoenix AMA
  - an area with 3 times more paper water than wet water

At ADWR's request, Global:

- Coordinated over 25 developer interests in the Lower Hassayampa Sub-basin
- Developed plans to provide reclamation & reuse throughout the area (all in the Phoenix AMA).

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GLOBAL WATER

West Maricopa Combine

Western & Northern Maricopa County, Mohave County, >50,000 acre service area

- Willow Valley Water was serving non-chlorinated water in a non-looped system that had a history of Total Coliforms and *E.Coli*

Chlorination and treatment systems are now in place, $2.7 million has been invested replacing and repairing lines and installing treatment systems.

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GLOBAL WATER

West Maricopa Combine

All of the $29.25 million in WMC acquisition costs was called "CIAC" and deducted from rate base.

Despite the fact that ICFAs specifically stated that the fees were intended to help Global acquire WMC.

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GLOBAL WATER

The Results of Turning Acquisition Costs into CIAC

- Global is unable to earn a return on the rate base WUGT <u>had when it was acquired</u>,
  - Global will be unable to earn any return on or of the **NEXT** $4.2 million it invests in WUGT.
- Global will receive no return *of* or *on*:
  - $26.5 million of currently used and useful plant in Maricopa,
  - $32 million it has already invested in Maricopa's "Southwest region".

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GLOBAL WATER

CARRYING COSTS

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GLOBAL WATER

Are Carrying Costs a Real Thing?

AFUDC

"One of the costs of building a new plant is the *interest* cost on cash tied up during construction."

Source: "Financial Accounting", Stickney & Weil, 9th edition

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GLOBAL WATER

Are Carrying Costs a Real Thing?

Bonbright

"[A]t least in times of rapid plant expansion, there arises a need for some rate-making provision whereby the company may eventually receive an adequate compensation for its advance commitment of capital."

Source: Principles of Public Utility Rates, Chapter XII, "Interest During Construction" section, paragraph two

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GLOBAL WATER

What Are Carrying Costs?

Permitting & Construction Costs
(AFUDC)

Capital costs (equity and debt), Insurance, and Maintenance Costs
(Carrying Costs)

Operation and Used/Useful
(Rate Base)

The costs that occur **after** AFUDC ends, and **before** plant enters rate base.

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Global Water

Are Carrying Costs Recoverable?

- In an unregulated industry, carrying costs may or may not be recoverable depending on supply and demand conditions – the market drives price, and returns vary widely.

- For regulated utilities carrying costs are definitely NOT recoverable.
  - Rates are set based on test year plant and expenses; the costs of plant *before* it is 'used and useful' don't make it into rates (save AFUDC).

40

Global Water

Developer Control?

- Least cost utility option is typically preferred, regardless of long-term impacts,
- Water resources are not their first priority
- MXA, AIAC and CIAC are very difficult to coordinate and administer for large service areas.

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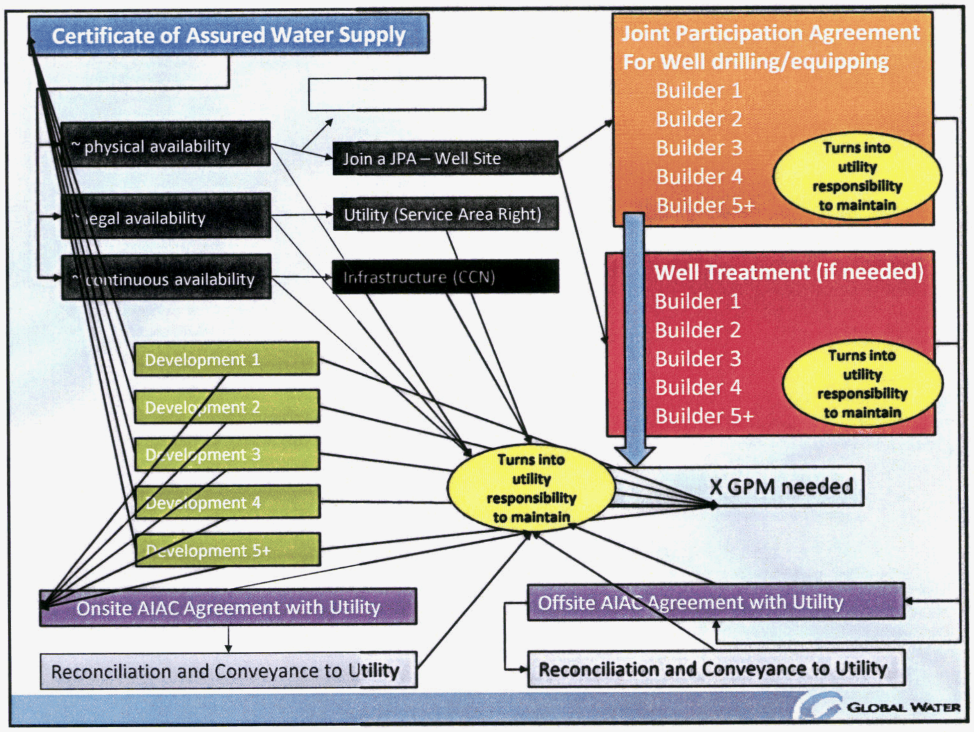

Why Does Global's History Matter?

Because the problems remain:

- Large service areas, water scarcity, growth, poorly run companies,
- Old infrastructure, undercapitalized utilities with little rate base and limited financial strength,
- Continued developer control of infrastructure through MXA, AIAC and CIAC,
- All acquisition costs remain unrecoverable, and
- Carrying costs remain unrecoverable – so regional plant is not financeable.

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What Does Global Need?

- We need the CIAC imputation of $26.5 million in used/useful rate base reversed and treated as debt/equity-financed plant,
- Leave the $32 million stranded assets in the "Southwest Area" out of rate base – but stop calling them CIAC,
- $43 million in acquisition costs should not be deducted from rate base.
- Create a better path – for everyone.
  - Develop a Pathway for ICFAs:
  - Lockbox and simple accounting,
  - Use developer money for acquisitions,
  - Use developer money to minimize carrying costs

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GLOBAL WATER

Attachment

"3"

GLOBAL WATER

RELIABLE RENEWABLE REUSABLE

Accounting for Infrastructure Coordination & Financing Agreements

Brett Higginbotham, CPA
Controller

Background

- Joined Global in February 2010
- 10 years with PricewaterhouseCoopers LLP
- Masters Degree of Accountancy from BYU
- Certified Public Accountant Licensed in Arizona

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GLOBAL WATER

Historical Method of Accounting for ICFAs

- Prior to January 1, 2010 (prior to the year of the rate case decision):
  - ICFA funds received were recorded as Deferred Revenue Liabilities.
  - Recognizing the ICFA funds as revenue coincided with the completion of Global's performance obligations under the ICFA.
- Because the ICFA are between the parent company and the developers, all IFCA revenue recognized were recorded in the income statement of the parent company.

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GLOBAL WATER

Historical Method of Accounting for ICFAs

GLOBAL WATER RESOURCES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	2010	2009	2008
		(in thousands)	
REVENUES:			
Water services	$ 15,000	$ 13,701	$ 13,684
Wastewater and recycled water services	7,663	6,683	6,605
Infrastructure coordination and financing fees	-	12,858	12,969
Sale of stored water credits	2,151	2,256	1,136
Unregulated revenues	3,712	330	768
Total revenues	28,526	35,828	35,162
OPERATING EXPENSES:			
Operations and maintenance	8,642	5,414	5,687
Cost of stored water credits sold	2,008	1,176	714
General and administrative expense	7,062	7,293	11,513
Goodwill impairment	23,985	-	8,742
Regulatory provision	55,169	-	-
Depreciation and amortization	7,472	12,646	11,364
Total operating expenses	104,338	26,529	38,020
OPERATING INCOME (LOSS)	(75,812)	9,299	(2,858)
Other income (expense)	(13,076)	(17,190)	(4,755)
Income tax benefit	3,847	3,247	2,585
NET LOSS	$ (85,041)	$ (4,644)	$ (5,028)

GLOBAL WATER

Historical Method of Accounting for ICFAs

Global Water Resources Inc.
Consolidated Balance Sheets
As of December 31, 2010 and 2009

	2010	2009
	(in thousands of US$)	
ASSETS		
PROPERTY, PLANT AND EQUIPMENT:		
Net property, plant and equipment	$ 272,493	$ 278,271
CURRENT ASSETS:		
Total current assets	14,602	3,691
OTHER ASSETS:		
Goodwill	13,082	37,067
Other	41,285	39,859
Total other assets	54,367	76,926
TOTAL	$ 341,462	$ 358,888
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Total current liabilities	$ 28,077	$ 32,196
NONCURRENT LIABILITIES:		
Long-term debt	117,361	165,088
Deferred revenue	-	23,357
Advances in aid of construction	104,043	104,524
Contributions in aid of construction — net	63,360	1,144
Other noncurrent liabilities	17,003	32,040
Total noncurrent liabilities	301,767	326,153
Total liabilities	329,844	358,349
EQUITY	11,618	539
TOTAL	$ 341,462	$ 358,888

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GLOBAL WATER

Basis for Historical Method of Accounting

- "Unless an accounting order indicates the way a cost will be handled for rate-making purposes, it causes no economic effects that would justify deviation from the Generally Accepted Accounting Principles ("GAAP") applicable to business entities in general."
  - Accounting Standards Codification 980-10-05-8 (formerly Financial Accounting Standard No. 71)

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Basis for Historical Method of Accounting (continued)

- FASB Statement of Financial Accounting Concept No. 6, par. 78-79:

  "Revenues are inflows or other enhancements of assets or an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations."
- FASB Statement of Financial Accounting Concept No. 5:
  - revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled the benefits represented by the revenues, and
  - revenues are considered to be realized or realizable when the seller receives cash from the customer or receives an asset that is readily convertible into cash.

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Basis for Historical Method of Accounting (continued)

- Securities and Exchange Commission Staff Accounting Bulletin (SAB) Topic 13-A states that revenue generally is realized or realizable and earned when all of the following criteria are met:
  - Persuasive evidence of an arrangement exists,
  - Delivery has occurred or services have been rendered,
  - The seller's price to the buyer is fixed or determinable, and
  - Collectability is reasonably assured
- After executing ICFA agreements, Global's stated revenue recognition criteria mirrors those from SAB Topic 13-A:
  - The fee is fixed and determinable,
  - The cash received is nonrefundable, and
  - There are no additional significant performance obligations

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GLOBAL WATER

Audit of Historical Financial Statements

- All of Global's historical financial statements have been subject to comprehensive annual audits conducted by an independent auditor, Deloitte and Touche LLP
- Unqualified ("clean") opinions were issued in every year since inception.

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GLOBAL WATER

Deloitte.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Global Water Resources, Inc.
Phoenix, Arizona

We have audited the accompanying consolidated balance sheets of Global Water Resources, Inc. and subsidiaries (formerly Global Water Resources, LLC and subsidiaries and Global Water Management, LLC) (the "Company"), as of December 31, 2010 and 2009, and the related consolidated statements of operations, shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

March 25, 2011

Audit of Historical Financial Statements – (continued)

So what does a US GAAP audit entail?

2010 Example:

- Deloitte audit team included: 3 partners, 1 Director, 1 Senior Manager and 1 Manager (all of whom are CPAs). The team also included 2-5 staff and senior staff level auditors who were on-site daily or regularly between August 2010 and March 2011.
- Approximately 2,000 hours incurred by Deloitte.
- Examination of financial records and detailed testing of transactions on a sample basis throughout this 2010 period.
- Consideration of Global's internal controls and accounting policies for conformity with US Generally Accepted Accounting Principles.
- Auditor's work was subject to review by partners and specialists with expertise in regulatory, tax, and other complex accounting matters.

Impact of Decision 71878

	2009		2010
Balance Sheet			
Assets			
Goodwill	$37.1 MM	→	$13.1 MM
Liabilities			
Deferred Revenue	$23.4 MM	→	$ -
CIAC – Net	$1.1 MM	→	$63.4 MM
Income Statement			
Revenues			
ICFAs	$12.9 MM	→	$ -
Expenses			
Goodwill Impairment	$ -	→	$24.0 MM
Regulatory Provision	$ -	→	$55.2 MM
Net Loss	**$(4.6) MM**	→	**$(85.0) MM**

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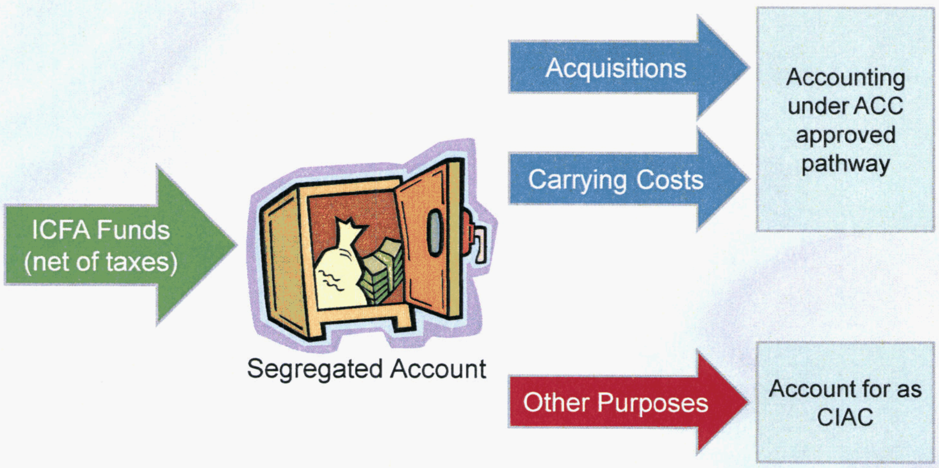
Proposed Future Treatment



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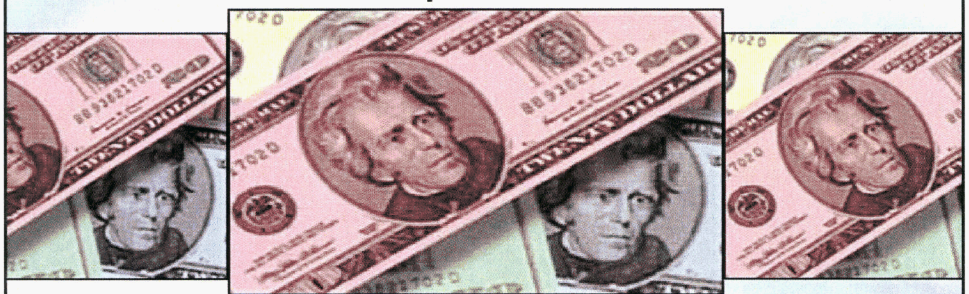
GLOBAL WATER

"Color Coding" Revenue and Expenses



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"Color Coding"

Some criticized Global's position because specific ICFA revenues could not be tracked dollar for dollar to specific uses.

Such tracking is not done in normal accounting or utility ratemaking:

- Customers in established neighborhoods impose different costs on utilities than those in new developments. These different costs are not tracked and rates are aggregated.
- AIAC and CIAC are deducted as a lump sum from rate base, they are not deducted line item by line item from the plant accounts on the General Ledger.

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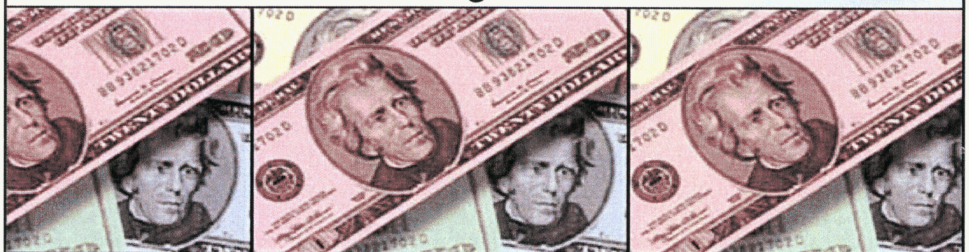
"Color Coding"

The previous owners of WMC used "Joint Participation Agreements" to track specific plant projects to specific developer MXAs. Global has found these agreements to be an administrative nightmare.



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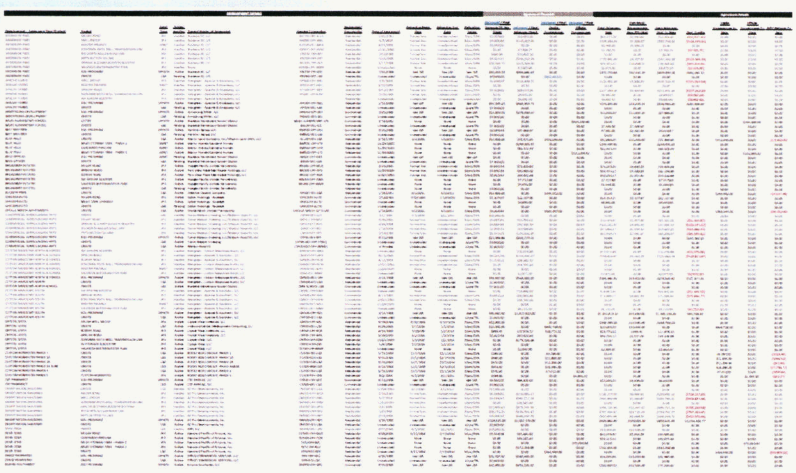
"Color Coding"



WMC's JPAs (One page of many needed for tracking of plant to specific developers.)

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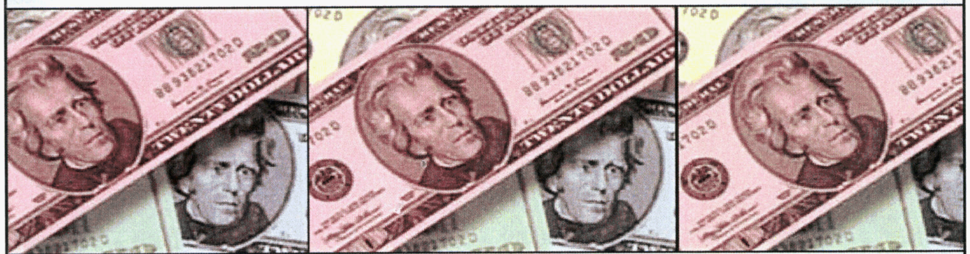
"Color Coding"

Notwithstanding the above Global is now keeping all ICFA fees received in a separate account and their actual uses will be traceable.



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“4”

ROSHKA DEWULF & PATTEN

ATTORNEYS AT LAW

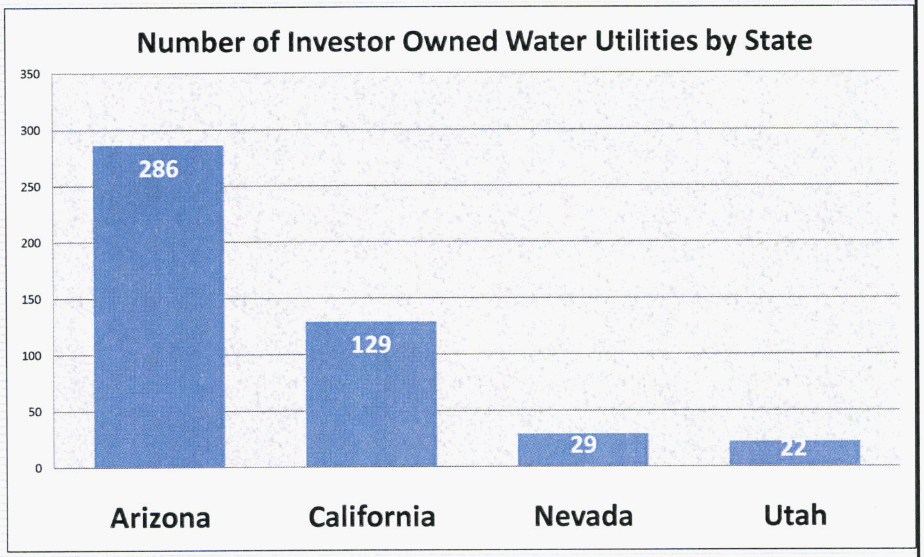
Arizona Corporation Commission
Water Finance Workshop
Docket No. W-00000C-06-0146
June 24, 2011

Using Developer Money To Pay For Acquisitions

Legal and Policy Issues

Timothy J. Sabo

Does the ACC Need an Acquisition Policy?



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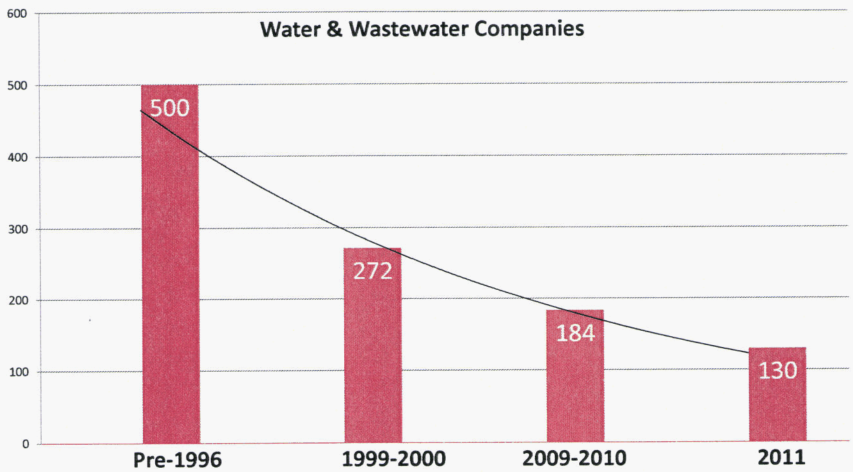
Pennsylvania Policy Statement on Acquisition Incentives

52 Penn. Admin. Code §§ 69.711, 69.722



Source – Pennsylvania PUC annual reports; Steve L. Klick, Executive Policy Manager to the Chairman, PaPUC

So what's the acquisition policy in Arizona? There isn't one.

Sabo:	Could you tell me what is the Commission's policy, if any, with respect to... acquisitions of small water companies by larger water companies?
Staff Witness:	I am not aware that there is a written policy.
Sabo:	Is there an unwritten policy?
Staff Witness:	.... I just don't know how to answer that question....
Sabo:	... can you tell me if Staff has a policy with respect to the acquisition of small water companies by larger water companies?
Staff Witness:	... No, not that I'm aware of.

[Staff Witness, 28 Dec. 2009 Tr. at 786-788]

Objection to Acquisition Policy

It will just enrich bad utility owners

Response to Objection

Most small utility owners are doing the best they can.

- Investing their own money - usually make little or no profit
- Personal credit at risk
- Time and effort
- Liability
- Almost always providing safe and reliable water

Response to Objection
Which do you prefer?

But former owner gets $$

Owner remains in place, gets $ from operating margin and salary

Promoting Acquisitions Policy Options

- ICFAs
  - Uses Developer Money
  - Ratemaking Issues
- Main Extension Agreements
- Acquisition Adjustment
  - Uses Ratepayer Money
- Forced Sale

What is an ICFA?

- ICFA = Infrastructure Coordination and Financing Agreement
- Developer and Utility Holding Company
- ICFA Funds
  - not tied to specific infrastructure
  - not tied to specific utility
  - can be used for multiple purposes
    - Acquisitions
    - Carrying costs for regional infrastructure

ICFA-funded acquisitions Real Life Examples

West Maricopa Combine

- 5 utilities; fragmented infrastructure
- Serious water quality issues
  - Arsenic
  - Iron & Manganese
  - Total Coliform and E. Coli
- ICFAs required purchase of WMC by Global
- ICFA funds used to pay a majority of the purchase price

ICFA-funded acquisitions Real Life Examples

387 Water and Wastewater Domestic Improvement Districts

- Emergency situation – 387 not able to serve
  - See Decision Nos. 68498, 70133, and 71238
- Global works with Developers, County, ADEQ to acquire districts' assets
- Developers in district service areas sign ICFAs as part of the asset transfer
- ICFA fees help fund purchase price

ICFA-funded acquisitions
Real Life Examples

CP Water Company

- No employees, approx. 1,000 acre service area
- Owned by developer
- ICFA requires transfer of CP to Global
- CP now included in Global regional plans; pending CC&N transfer

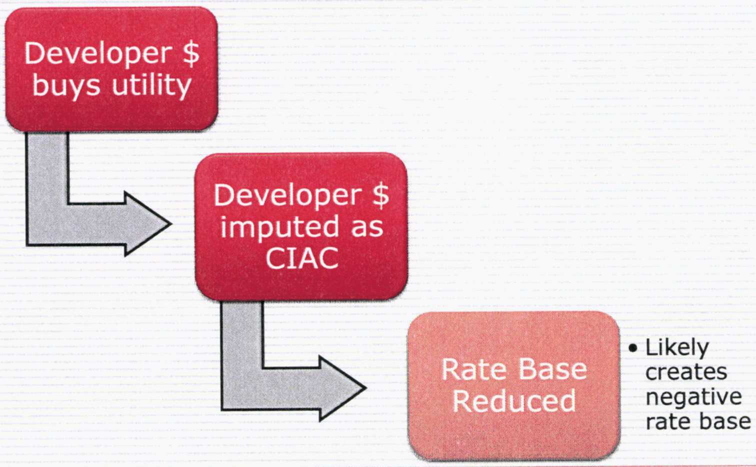
ICFA RATEMAKING ISSUES

Fair Value – What happens when a utility is bought for more than book value?

No Change to Fair Value
- **Rate Base Two Step**
- **Stable Rate Base**

Change Fair Value
- **Market Value**
- **Eradicate Rate Base**

Eradicate Rate Base Introduction



Eradicate Rate Base Example

	No Purchase – Utility Remains with Current Owner	Utility Purchased with $10MM in Developer Funds
Managerial Capability	✗	✓
Technical Capability	✗	✓
Financial Capability	✗	✓
Rate Base Change	$ 0	$(10MM)

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Eradicate Rate Base Global Rate Case - WUGT

Rate Base per Application

$2.56MM

CIAC Imputation of ICFA fees

$(4.18MM)

Rate Base per Decision

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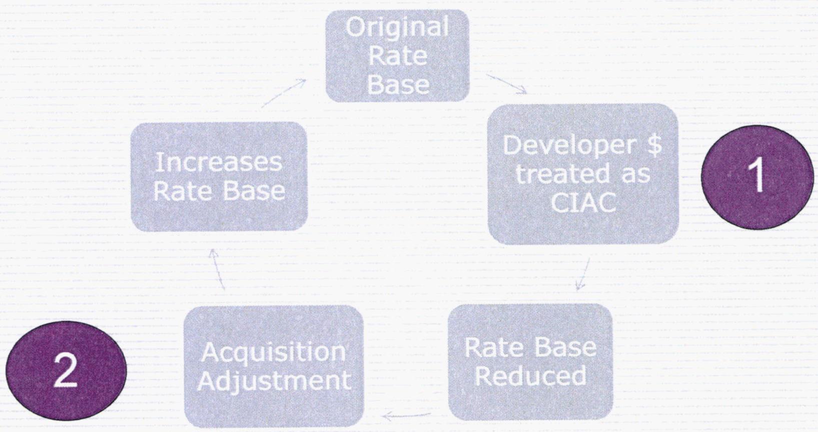
Eradicate Rate Base - Summary

- Pros
  - Rate base reduced?
- Cons
  - Why would anyone buy under this option?
  - **<u>Rate Base Black Hole</u>** - Even if deal happens, utility stuck with negative rate base – destroying incentive to invest

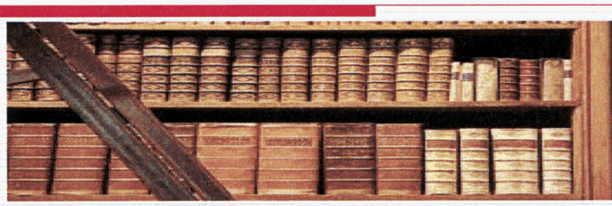
Rate Base Two Step



Rate Base Two Step - Summary

- Pros
  - Revenue-neutral
  - Encourages acquisition and consolidation
- Cons
  - Buyer will want some assurance of acquisition adjustment
  - Commission action required to approve acquisition adjustment
  - Delay – sometimes quick action needed
    - 387 Example

The Stable Rate Base Method ACC Rules



Original cost is the cost "at the time it is first devoted to pubic service."
A.A.C. R14-2-102(A)(6)

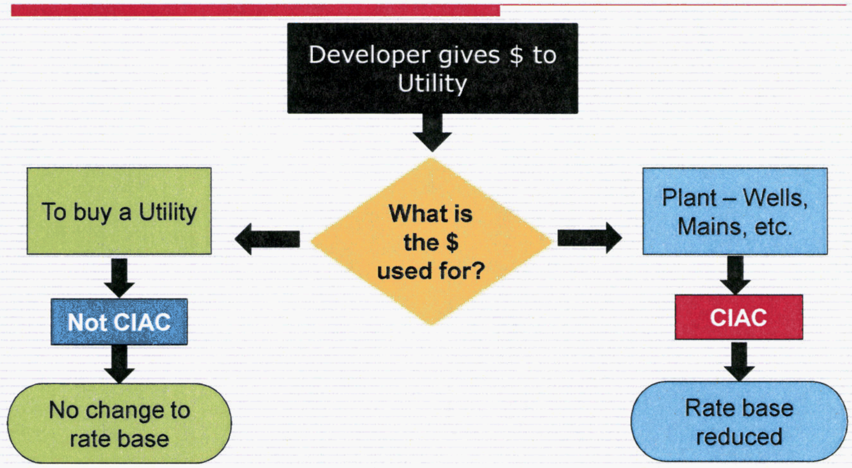
Original cost is the "cost of [the] property to the person first devoting it to public service."
A.A.C. R14-2-103(A)(3)(e)

ACC Open Meeting Comments of Mr. Steve Olea

"...if there was a way that the company could show that 'I receive $1 million in an ICFA, and it's right here. Now I used that million dollars to go acquire this company,' ... I think in that case Staff might have a different look... **because I know it did not pay for a piece of pipe, it didn't pay for a well, it didn't pay for any kind of treatment plant. It paid to acquire a company."**

[25 Aug. 2010 Tr. at 164-165, emphasis added]

The Stable Rate Base Method Ratemaking Test



The Stable Rate Base Method Summary

- Pros
  - Revenue-neutral
  - Encourages acquisition and consolidation
  - No Commission action needed
- Cons
  - Previous owner enriched?

Acquisitions Additional Policy Options

- Main Extension Agreement
- Acquisition Adjustment
- Forced Sale

Using MXAs for Acquisitions?

Problem One – ACC Main Extension Rules

- Require MXA funds to be spent on plant
- MXA proceeds are either CIAC or AIAC

Problem Two – If CIAC, "eradicate rate base"

Problem Three – If AIAC, at first "eradicate rate base", then repayment of AIAC may add acquisition premium to rate base

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Main Extension Agreement Rules

- Rule R14-2-406(B) – "An applicant for the extension of mains may be required to pay to the Company, as a refundable advance in aid of construction… the reasonable cost of all mains, including all valves and fittings"
- Rule R14-2-406(B)(1) – "In the event that additional facilities are required to provide pressure, storage or water supply… the estimated reasonable cost of such additional facilities may be included in refundable advances in aid of construction…"

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Main Extension Agreements Definitions in ACC Rules

- "Advance in aid of construction." Funds provided to the utility by the applicant under the terms of a main extension agreement the value of which may be refundable. R14-2-401(1).
- "Contributions in aid of construction." Funds provided to the utility by the applicant under the terms of a main extension agreement and/or service connection tariff the value of which are not refundable. R14-2-401(8)
- "Main extension" The mains and ancillary equipment necessary to extend the existing water distribution system to provide service to additional customers. R14-2-401(14).

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Acquisition Adjustment

- Increase rate base by some or all of acquisition premium
  - **Ratepayers pay for it**
  - Except in "Rate Base Two Step", results in increased rates
- Requires ACC action to approve adjustment
  - Strongly disfavored by ACC; per Staff, used twice in last 20 years. [28 Dec. 2009 Tr. at 788-790]

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Forced Sale Concept

ACC issues OSC against small water co.; appoints interim operator; ACC pressures owner to sell.

Forced Sale Concept

- Likely not a viable approach in most circumstances
- Given current industry structure, multiple approaches needed
- Challenges & Potential Problems
  - 8 Potential Legal Issues
  - 4 Practical Concerns

Forced Sale Concept Potential Legal Issues

1) Reactive – requires violation
2) Interim Operator – unclear / untested in court
3) Fine limited to $5,000 per violation
4) High legal standard for CC&N revocation
5) Takings – just compensation requirement
6) Takings – public use requirement
7) Management Interference Doctrine
8) Affiliated Interest Rules – ACC approval needed for Class A utility to buy, even in forced sale situation

Forced Sale Concept

Potential Legal Issue # 1– OSC can only be issued for violation of statute, rule or order

- "Complaint may be made by the commission of its own motion... setting forth any act or thing done or omitted to be done by any public service corporation in violation, or claimed to be in violation, **of any provision of law or any order or rule of the commission**,..." A.R.S. § 40-246(A)(emphasis added)
- Typically ACC becomes aware of rule violations only when utility fails – reactive, not proactive – waiting for failure is not a strategy

Forced Sale Concept

Potential Legal Issue # 2 – legal authority for interim operator order somewhat unclear

- Never tested on appeal
- No specific constitutional or statutory authority
- Arizona law gives superior court authority to appoint receiver
  - ARS §§ 12-1241; 12-1242

Forced Sale Concept

Potential Legal Issue # 3 – ACC fine authority limited to $5,000 per violation

- Arizona Constitution, Article 15 §§ 16, 19
- A.R.S. § 40-424
- Previously, ACC used the "each day is a separate offense" theory
- This theory rejected by the Arizona Court of Appeals in *Southern California Edison Co. v. ACC,* No. 1 CA-CV 10-0273 (March 10, 2011)(memorandum opinion)(petition for review filed)

Forced Sale Concept

Potential Legal Issue # 4 – Hard to revoke CC&N

"Only upon a showing that a certificate holder, presented with a demand for service which is reasonable in light of projected need, has **failed to supply such service** at a reasonable cost to customers, can the Commission alter its certificate."

James P. Paul Water Co. v. Arizona Corp. Comm'n, 137 Ariz. 426, 429, 671 P.2d 404, 407 (Ariz. 1983)(emphasis added)

Forced Sale Concept

Potential Legal Issue # 4 – Hard to revoke CC&N (Continued)

"Issuing certificates of convenience and necessity is far from a plenary power of the Commission. To the contrary, it is a legislative power delegated to the Commission **subject to restrictions as the legislature deems appropriate**."

Tonto Creek Estates Homeowner's Assoc. v. Arizona Corp. Comm'n, 177 Ariz. 49, 56, 864 P.2d 1081, 1088 (Ct. App. 1993)(emphasis added)

Forced Sale Concept

Potential Legal Issue # 5 – Takings - Just compensation

- The Fifth Amendment to the United States Constitution states in relevant part: "[N]or shall private property be taken for public use, without just compensation."
- The Due Process Clause of the Fourteenth Amendment applies the Takings Clause to the states.
- Arizona Constitution, Article 2, Section 17 "No private property shall be taken or damaged for public or private use without just compensation having first been made...."
- *See e.g. Southwest Sand & Gravel, Inc. v. Central Ariz. Water Conservation Dist.,* 221 Ariz. 309, 313 n. 1, 212 P.3d 1, 5 (Ct. App. 2008).

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Forced Sale Concept

Potential Legal Issue # 6 – Takings – Public Use

"Taking one person's property for another person's private use is plainly prohibited, with a few specific exceptions not applicable here."

Bailey v. Myers, 206 Ariz. 224, 227 ¶ 12, 76 P.3d 898, 901 (Ct. App. 2003)

Is taking a water company from Person A and giving it to Person B a "public use" or a "private use"?

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Forced Sale Concept

Potential Legal Issue # 7

Management Interference Doctrine

- The "managerial interference doctrine is a judicial construct designed to protect regulated corporations from over-reaching and micro-management of their internal affairs by the Commission." ¶ 23
- The ACC may "attempt to control rates", but may not "attempt to control the corporation" ¶ 20

Miller v. Arizona Corporation Commission, Case No. 1 CA-CV 09-0789 (Opinion, filed April 7, 2011)

Forced Sale Concept Potential Legal Issue # 8

- Public Utility Holding Company and Affiliated Interests Rules
  - A.A.C. R14-2-801 to 806
  - Under the rules, Class A utilities need approval to acquire the stock of smaller utilities
  - But the owner of a small utility can buy the stock of another small utility without any ACC approval

Forced Sale Concept Practical Issue # 1

Who Buys?

- Regulator selecting who they want to buy a utility
  - sound familiar?

Southern Union Co. v. Irvin

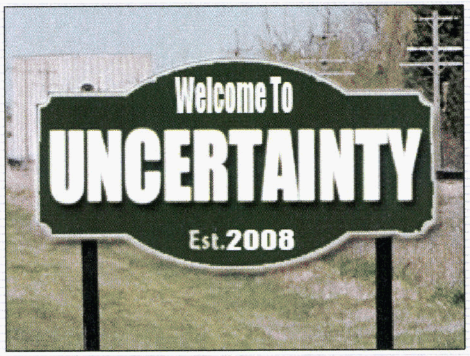
Forced Sale Concept Practical Issue # 2

Why would someone want to buy a troubled utility with massive regulatory issues?

"We're under capitalized. As soon as we reach the break even point we'll buy a lemon."

Forced Sale Concept Practical Issue # 3

- Regulatory Uncertainty
  - Actually discourages investment by current owner for fear it may be taken away



Forced Sale Concept Practical Issue # 4

- How do you get an interim operator before the forced sale goes through?
  - Guaranteed Operating Losses
  - Significant time investment
  - Potential legal liability from owner
  - Often no exit strategy

Forced Sale Concept
Practical Issue # 4 - Examples

- Hacienda Acres
  - ACC approves interim operator
  - Global agrees to be interim operator
  - Global loses money each month - over $200,000 in uncompensated expenses
  - Insufficient customers to support needed expenses
  - Still not owned by Global
  - Still not connected to Global system

Hacienda Acres Example

- *Arizona State Corporation Commission v. Joseph W. Lee*
  - Maricopa County Superior Court
  - Court grants Permanent Injunction against Mr. Lee
  - But Court notes Mr. Lee has potential legal claim against ACC for inverse condemnation
  - "A violation of Mr. Lee's rights may have occurred" regarding notice
  - Case No. CV 2007-015778, Minute Entry dated March 3, 2009, Paragraph 89

Forced Sale Concept
Practical Issue # 4 - Examples

- Sabrosa Water Company
  - Past interim operators
    - Arizona-American Water Co.
    - Global Water (Cave Creek Water Co.)
    - Town of Cave Creek
  - Per Sabrosa 2010 Annual Report
    - Current Interim Operator Mr. Don Bohlier
    - Net income = $(13,713)
    - 37 customers
    - Water Loss = 45%

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Forced Sale Concept
Practical Issue # 4 - Examples

- Valle Verde Water Company
  - Interim operator appointed 2007
  - Emergency Rate Case 2007
  - General Rate Case & Financing
    - Filed 2009
    - Decided 2010
  - Company still subsidized by interim operator and other creditors
  - No long-term ownership solution

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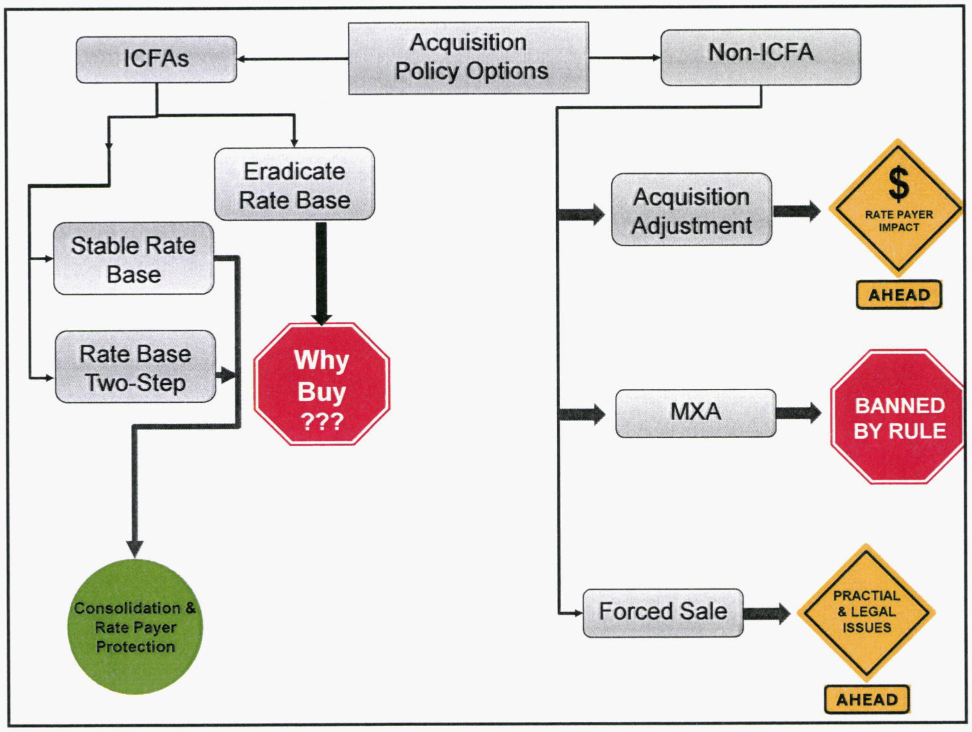
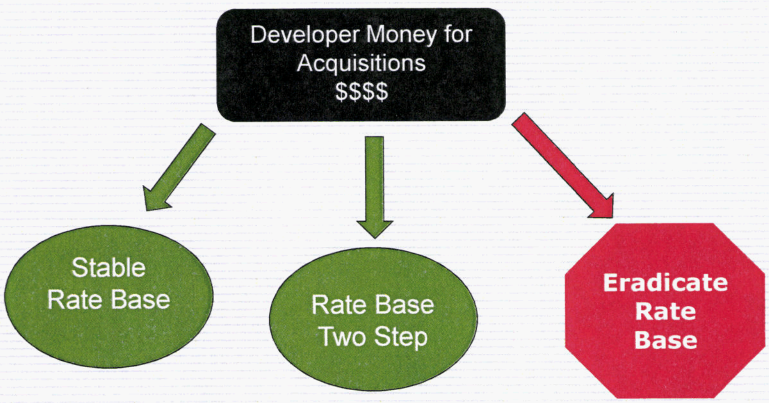


Developer Funded Acquisitions



Roshka DeWulf & Patten PLC 52

Attachment

"5"

Carrying Costs and ICFAs

Presented by
Matthew Rowell

Desert Mountain Analytical Services PLLC

1

What Are Carrying Costs?

Carrying Costs are the costs incurred as a result of making a particular investment.

Include real cash expenses (e.g., interest on debt used to finance the investment) and the opportunity cost associated with devoting capital to a particular investment.

2

How to deal with Carrying Costs of Regional Plant?

More frequent rate cases: will not solve problem because plant may not be used and useful and because of regulatory lag. Even if we assume these problems away, would result in customers paying more.

Redefine AFUDC such that it applies to time period after construction is complete (i.e., take off the DC.)

CIAC and/or AIAC: Very difficult to use with multiple developers all with different time frames. Additionally, R14-2-406 and 606 limit the use of MXAs for regional plant.

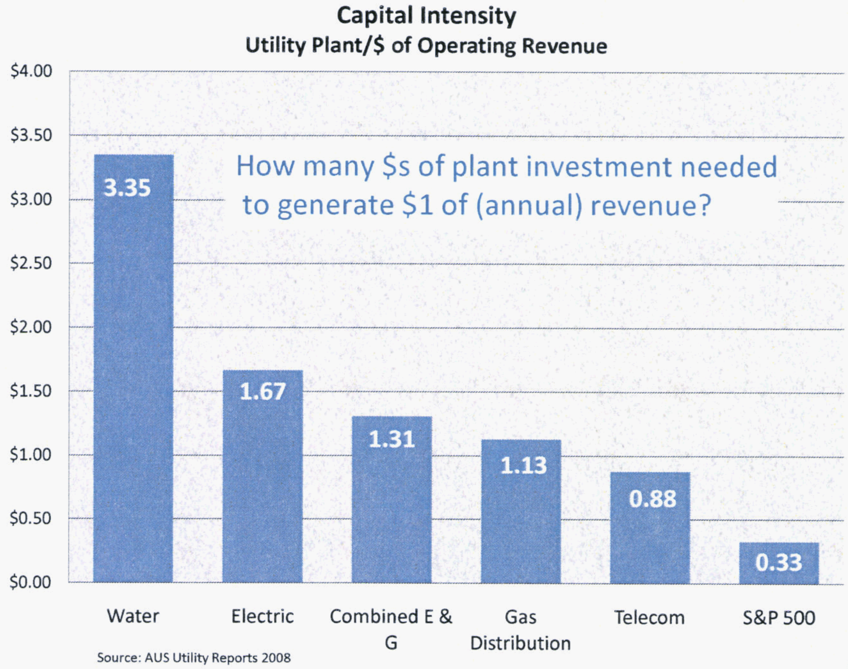
ICFAs

3

Carrying Costs

Carrying Costs are especially relevant in the water/wastewater industry because of its high capital intensity.

4



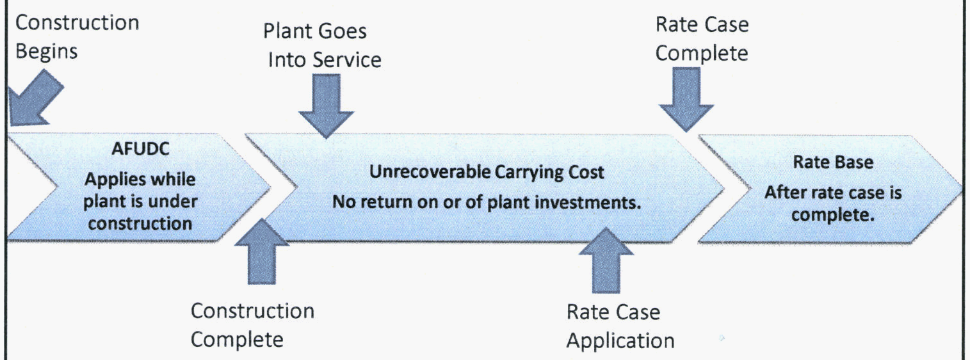
5

Carrying Costs

Between the time when plant is emplaced and it is included in rates carrying costs go uncompensated. That is, there is no return on (or of) plant investments.

6

Plant Time Cycle



7

Carrying Costs

(T)he general practice historically was to withhold from the rate base major plant construction costs until the plant itself has become part of the "used and useful" property.

As long as this withholding practice existed, there arose a need for some ratemaking provision whereby the company might eventually receive an adequate compensation for its advance commitment of capital.

James C. Bonbright et. al. *Principles of Public Utility Rates*, Second Edition, 1988, Public Utility Reports, Inc. Chapter 12 page 247.

8

Why should the ACC care about carrying cost?

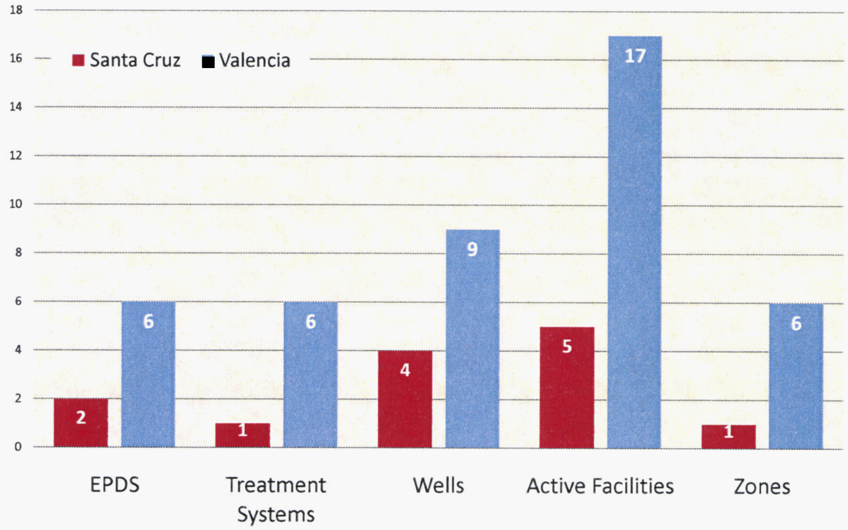
Are customers protected by making utilities carry these costs?

9

Without some way to address carrying costs large capital projects become cost prohibitive.

10

Regional Plant Leads to Efficiency

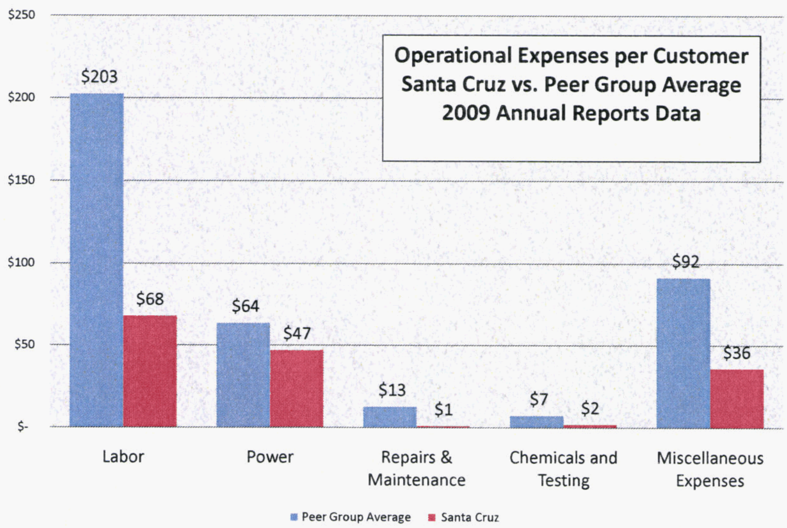


Santa Cruz: 17,237 customers, 16 square miles
Valencia: 5,685 customers, 12 square miles

Note: topography is similar in both service areas.

11

Regional Plant Leads to Efficiency



Peer Group:
Arizona American, Chap City, H2O, Johnson Utilities, Lago Del Oro, Litchfield Park, Pima, Vail, Valencia- GB, Valle Verde, Willow Valley.

12

Examples of How Arizona Utilities Have Dealt With Carrying Costs

13

Special CWIP provisions for Palo Verde Nuclear Generation Station during its construction.

- Resulted in customers paying for plant not yet in service (but allowed for efficient base load generation over long term.)

14

AIAC used to build the Anthem plant.

- Solved immediate problem but left customers exposed to significant rate increases in the future.

Some utilities have avoided carrying costs by building plant on a piecemeal basis relying heavily on CIAC and/or AIAC.

- This solves the immediate carrying cost problem but leads to significant maintenance and repair expenses, operational inefficiencies, and a lack of financial viability over time.
  - E.g., Valle Verde, Valencia, Willow Valley, WUGT, Cave Creek, Desert Hills, Hacienda Acres, Sabrosa, McLain and others.

In Docket No. E-01345A-10-0474 APS is asking for an accounting order that allows for the deferral for future recovery of carrying costs (and other costs) associated with their purchase of Units 4 and 5 of the Four Corners Power Plant.

17

The ICFA alternative solves the carrying cost problem without detrimentally affecting customers.

- Under the ICFA concept developers contribute to the carrying costs – **not utility customers**.

18

Global's Historic Carrying Costs

Global's Historic Carrying Costs

From 2004 to July 30, 2010 (the effective date of the rate case) over $100 MM of plant was added to Palo Verde and Santa Cruz.

Over that time that plant imposed **$25.19 MM** in carrying costs on Global.

The WACC approved in Global's rate case: 7.8%

To be conservative, customer growth was accounted for.

Year	PV and SC Plant In Service - net of AIAC & CIAC	Net Plant in Service - Half period convention	South West Plant	Carrying Cost @ 7.80%	Adjusted Operating Profit (Loss)	Uncovered Carrying Cost	Cumulative uncovered carrying cost
04	$ 15.66	$ 14.42	-	$ 1.12	$ 1.25	$ (0.12)	$ (0.12)
05	44.10	29.88	-	2.33	3.95	(1.62)	(1.75)
06	62.55	53.33	-	4.16	3.60	0.56	(1.19)
07	108.83	85.69	-	6.68	2.74	3.95	2.761
08	109.71	109.27	-	8.52	2.17	6.35	9.12
09	105.35	107.53	33.49	11.00	1.93	9.07	18.19
10 *	104.98	105.17	33.49	6.31	(0.69)	7.00	25.19

In millions.

*2010 is through July 30 only.

21

Staff and RUCO Position on Carrying Costs for Water/Wastewater Utilities

22

Staff and RUCO's position on carrying costs can be summarized as follows:

Ignore the issue.

23

Global's Position on Carrying Costs for Water/Wastewater Utilities

24

Recognize that ICFAs are an appropriate means to deal with carrying costs.

Allow carrying costs to offset the CIAC imputation of ICFA funds.

Reduce the CIAC imputation from the last rate case by the amount of the carrying costs.

How to undo the CIAC imputation?

In the last rate case, the ICFA CIAC imputation was allocated as follows:

Utility	Rate Base Impact	Plant Held for Future Use
WUGT	$(7,085,645)	
Palo Verde	$(10,991,128)	
Palo Verde SW Plant		$(14,449,976)
Santa Cruz	$(6,600,076)	
Santa Cruz SW Plant		$(17,941,342)
Total	$(26,613,954)	$(32,391,318)

Source: Exhibit B to Global Rate Case Decision 71878

How to undo the CIAC imputation?

"(N)ormally when you make a decision on rate base in an order, it's done, and the companies cannot come back and say, well, you know, if you treat it different in the next case or the next rate case. What Staff believes your Amendment No. 4 does is that it does allow just that; it allows that this may not be a permanent reduction to rate base. **If something comes out of those workshops where it says that, 'you should have treated it different, Commission,' then we can do that in the next rate case.**"

- ACC Utility Division Director Steve Olea, Open Meeting Transcript Pg 280

27

Attachment

"6"

IS FUNGIBILITY A BAD WORD?

ARE ICFAS "TOO FUNGIBLE"?

Some argued that Global could recover ICFA fees from a developer and use that money in another area in order to acquire a troubled utility, and then use its own capital to fix the utility.

They argued that made ICFAs "fungible" and that was a bad thing.

WHO LIKES FUNGIBILITY?

- Milton Friedman in "Money Mischief" explained that the primary value of money is that it is fungible, which is precisely what allows money to be used for exchange.
- Ludwig von Mises in "The Theory of Money and Credit" explained that "money is nothing but a medium of exchange and it completely fulfills its function when the exchange of goods and services is carried on more easily…"
  - **Fungibility allows companies and individuals to use money when and where it is most useful.**

FUNGIBLE IN UTILITY ECONOMICS

- Consider a 51-year old home in Central Mesa and a brand new home in East Mesa:
  - The homes pay the same utility rates
- The Utilities serving both homes do not color-code their dollars:
  - They do not color-code rate base nor provide discounts after a homeowner has paid "his fair share", or paid more towards the rate base than another homeowner.

8348 E. Indigo Street, Mesa
Built 2011.
List Price on Zillow, $271,950

- ZERO years' worth of payments for SRP and CAP Canals
- ZERO years' worth of payments for electric transmission lines
- ZERO years' worth of payments for Palo Verde NGS

532 S. Mulberrry, Mesa
Built 1960.
List Price on Zillow, $39,000

- 50 years' worth of payments for SRP and CAP Canals
- 50 years' worth of payments for electric transmission lines
- 30 years' worth of payments for Palo Verde NGS

STOPPING FUNGIBILITY?

- Are we going to tell the new home on Indigo Street to pay more? Should they pay off the people on Mulberry Street?
  - If we do, we stop growth, and that hurts Mulberry Street.
- Should we tell utilities to have different rate zones?
  - Should we tell utilities to color code dollars and only spend East Mesa's money on projects that benefit East Mesa?

ATTACHMENT

"7"

RESOLUTION NO. 11-40

A RESOLUTION OF THE MAYOR AND CITY COUNCIL OF THE CITY OF MARICOPA, ARIZONA, SUPPORTING THE USE OF INFRASTRUCTURE COORDINATION AND FINANCING AGREEMENTS IN FURTHERANCE OF AN APPROACH TO TOTAL WATER MANAGEMENT AND WHEN CONDITIONED ON THE USE OF CERTAIN PATHWAYS AS ONE OF THE METHODS AVAILABLE TO GLOBAL WATER AND OTHER UTILITIES AND DEVELOPERS IN EXPANDING REGIONAL UTLITY INFRASTRUCTURE WITHIN THE CITY OF MARICOPA.

WHEREAS, Global Water Resources, Inc is a provider of water and wastewater services to the greater Maricopa area through its subsidiaries Global Water – Santa Cruz Water Company and Global Water – Palo Verde Utilities Company; and

WHEREAS, the City of Maricopa recognizes Global Water as an important strategic partner in the area's past and future development through the provision of water, wastewater, and recycled water infrastructure and operations to serve the greater Maricopa area; and

WHEREAS, in order to attract, facilitate, and manage further growth in the City of Maricopa, the City wishes to work with Global Water to provide a means by which to facilitate appropriately priced and sustainable water, wastewater, and recycled water services; and

WHEREAS, the City of Maricopa and Global Water have engaged in a series of discussions to educate each other on their respective organizational needs and challenges; and;

WHEREAS, through these discussions, the City received information from Global Water concerning Global Water's use of infrastructure coordination and financing agreements (ICFAs), and the City and Global Water mutually believe that ICFAs, when certain pathways are followed, foster consolidation of troubled water companies, enable better regional water planning, and provide a level of protection to rate-paying customers from the costs of acquisitions and infrastructure carrying costs; and

WHEREAS, the City recognizes the role Global Water's ICFAs played in the development of the City and is supportive of the use of ICFAs, with certain pathways, as a means to facilitate sound Total Water Management practices.

NOW, THEREFORE, BE IT RESOLVED by the Mayor and City Council of the City of Maricopa, Arizona with deference to the Arizona Corporation Commission, which has regulatory authority over the ultimate rate making treatment of ICFA's, the City generally supports the use of ICFAs, when certain pathways are followed, as one of the methods available to Global Water and other utilities and developers expanding regional utility infrastructure within the City of Maricopa conditioned on the ICFAs following certain pathways:

a. ICFA funds, reduced by normal tax effects, used to construct infrastructure shall be treated as contributions in aid of construction (CIAC) in accordance with normal industry practices.

b. Carrying costs associated with regional infrastructure used for Total Water Management and paid for by ICFA funds shall not be an allowable cost to be passed on to the rate-payers. However, ICFA funds used for these purposes shall not be treated or imputed as CIAC.

c. Costs associated with the purchase of undercapitalized utilities paid for from ICFA revenue shall not be an allowable cost to be passed on to the rate-payers. However, ICFA funds used for these purposes shall not be treated or imputed as CIAC.

d. If ICFA funds are used in connection with acquisitions, all of the following shall apply:

    i. Use of developer funds to acquire utilities shall preclude Global and any other utility from seeking a regulatory "acquisition adjustment" that increases their regulated rate base to the extent of such use of developer funds.

    ii. The acquisition must be part of a regional plan of consolidation and conservation.

    iii. Developer(s) shall not exercise permanent control over the utility system, management, or planning as a result of the implementation of the ICFA.

NOW, THEREFORE, BE IT FURTHER RESOLVED that the City of Maricopa believes it is in the public interest and positively impacts regional water use planning to support the use of ICFAs conditioned on certain pathways being followed and as long as the ICFAs are used consistent with this Resolution and the rules and regulations that may be imposed by the Arizona Corporation Commission.

PASSED AND ADOPTED by the Mayor and Council of the City of Maricopa, Arizona, this 23rd day of June, 2011.

APPROVED:

Anthony Smith
Mayor

ATTEST:

City Clerk

APPROVED AS TO FORM:

City Attorney

ATTACHMENT

"8"

C

West's Pennsylvania Administrative Code Currentness
Title 52. Public Utilities
Part I. Public Utility Commission
Subpart C. Fixed Service Utilities
Chapter 69. General Orders, Policy Statements and Guidelines on Fixed Utilities
Small Nonviable Water and Wastewater Systems--Statement of Policy
→ **§ 69.711. Acquisition incentives.**

(a) *General.* To accomplish the goal of increasing the number of mergers and acquisitions to foster regionalization, the Commission will consider the acquisition incentives in subsection (b). The following parameters shall first be met in order for Commission consideration of a utility's proposed acquisition incentive. It should be demonstrated that:

(1) The acquisition serves the general public interest.

(2) The acquiring utility meets the criteria of viability that will not be impaired by the acquisition; that it maintains the managerial, technical and financial capabilities to safely and adequately operate the acquired system, in compliance with 66 Pa.C.S. (relating to the Public Utility Code), the Pennsylvania Safe Drinking Water Act (35 P. S. §§ 721.1--721.17) and other requisite regulatory requirements on a short and long-term basis.

(3) The acquired system has less than 3,300 customer connections; the acquired system is not viable; it is in violation of statutory or regulatory standards concerning the safety, adequacy, efficiency or reasonableness of service and facilities; and that it has failed to comply, within a reasonable period of time, with any order of the Department of Environmental Protection or the Commission.

(4) The acquired system's ratepayers should be provided with improved service in the future, with the necessary plant improvements being completed within a reasonable period of time.

(5) The purchase price of the acquisition is fair and reasonable and the acquisition has been conducted through arm's length negotiations.

(6) The concept of single tariff pricing should be applied to the rates of the acquired system, to the extent that it is reasonable. Under certain circumstances of extreme differences in rates, or of affordability concerns, consideration should be given to a phase-in of the rate difference over a reasonable period of time.

(b) *Acquisition incentives.* In its efforts to foster acquisition of suitable water and wastewater systems by viable utilities when the acquisitions are in the public interest, the Commission seeks to assist these acquisitions by permitting the use of a number of regulatory incentives. Accordingly, the Commission will consider the following acquisitions incentives:

(1) *Rate of return premiums.* Under 66 Pa.C.S. § 523 (relating to performance factor considerations), additional rate of return basis points may be awarded for certain acquisitions and for certain associated improvement costs, based on sufficient supporting data submitted by the acquiring utility within its rate case filing. The rate of return premium as an acquisition incentive may be the most straightforward and its use is encouraged.

(2) *Acquisition adjustment.* When the acquiring utility's acquisition cost differs from the depreciated original cost of the water or wastewater facilities first devoted to public use, the difference may be treated as follows for ratemaking purposes:

(i) *Credit acquisition adjustment.* Under 66 Pa.C.S. § 1327(e) (relating to acquisition of water and sewer facilities), when a utility pays less than the depreciated original cost of the acquired system, the acquiring utility may book and include in rate base the depreciated original cost of the acquired system, provided that the difference between the acquisition cost and depreciated original cost should be amortized as an addition to income over a reasonable period of time or be passed through to ratepayers by another methodology that is determined by the Commission. The acquiring utility may argue that no amortization or pass through is appropriate when the acquisition involves a matter of substantial public interest.

(ii) *Debit acquisition adjustment.* Under 66 Pa.C.S. § 1327(a), when a utility pays more than the depreciated original cost of the acquired system, the acquiring utility may book and include in rate base the excess of acquisition cost over depreciated original cost of the acquired system, provided that the utility can meet the requirements of 66 Pa.C.S. § 1327(a). When the acquisition does not qualify under 66 Pa.C.S. § 1327(a), the debit acquisition adjustment should be treated in accordance with generally accepted accounting principles and not be amortized for ratemaking purposes.

(3) *Deferral of acquisition improvement costs.* In cases when the plant improvements are of too great a magnitude to be absorbed by ratepayers at one time, rate recovery of the improvement costs may be recovered in phases. There may be a one time treatment--in the initial rate case-of the improvement costs but a phasing--in of the acquisition, improvements and associated carrying-costs may be allowed over a finite period.

(4) *Plant improvement surcharge.* Collection of a different rate from customers of the acquired system upon completion of the acquisition could be implemented to temporarily offset extraordinary improvement costs. In cases when the improvement benefits only those customers who are newly acquired, the added costs may be allocated on a greater than average level--but less than 100%--to the new customers for a reasonable period of time, as determined by the Commission.

(c) *Procedural implementation.*

(1) An acquiring utility that has met the criteria set forth in 66 Pa.C.S. § 1327(a)(1)--(9) for inclusion of a debit acquisition adjustment in its rate base, may elect to have this acquisition adjustment considered on a case-by-case basis as set forth in 66 Pa.C.S. § 1327(b), or as part of its next rate case filing. The acquiring utility should file the supporting documentation outlined in subsection (d) to support the requested acquisition adjustment.

(2) The appropriate implementation procedure to qualify for the other acquisition incentives in subsection (b) would be to file the appropriate supporting documentation during the next filed rate case.

(3) In acquisition incentive filings, the burden of proof rests with the acquiring utility.

(d) *Documentation to support inclusion of acquisition adjustment.* When an acquiring utility elects to have the acquisition adjustment to its rate base considered as a part of its next rate case filing, the acquiring utility should file the following documentation to support the acquisition adjustment to its rate base:

(1) *Statement of reliance on existing records.* An acquiring utility may elect to rely in whole or in part upon the original cost records of the seller or Commission in determining the original cost of the used and useful assets of the acquired system.

(2) *Preparation of data to support acquisition adjustment.* An acquiring utility, upon its own election, may file an original cost plant-in-service study with the Commission to support its requested acquisition adjustment to its rate base. An original cost study is one method of determining the valuation costs of the property of a public utility. It

requires the acquiring utility to develop realistic plant balances and accumulates the records and accounting details that support those balances. Disputes regarding the acquiring utility's original cost valuation of the assets of the acquired system will be resolved in the context of a rate proceeding when interested parties will have an opportunity to be heard.

(i) *Contents of an original cost plant-in-service study.* When an acquiring utility elects to submit its own original cost of plant-in-service valuation, the acquiring utility is obligated to exercise due diligence and make reasonable attempts to obtain, from the seller, documents related to original cost. In particular, as part of its exercise of due diligence, the acquiring utility should request from the seller, for purposes of determining the original cost plant-in-service valuation, the original cost of the assets being acquired and records relating to contributions in aid of construction (CIAC), such as the following:

(A) Accounting records and other relevant documentation and agreements of donations or contributions, services, or property from states, municipalities or other government agencies, individuals, and others for construction purposes.

(B) Records of unrefunded balances in customer advances for construction (CAC).

(C) Records of customer tap-in fees and hook-up fees.

(D) Prior original cost studies.

(E) Records of local, State and Federal grants used for construction of utility plant.

(F) Relevant PennVEST or Department of Environmental Protection records.

(G) Any Commission records.

(H) Summary of the depreciation schedules from all filed Federal tax returns.

(I) Other accounting records supporting plant-in-service.

(ii) *Failure of seller to provide cost-related documents.* The failure of a seller to provide cost-related documents, after reasonable attempts to obtain the data, will not be a basis for the Commission's denial of the inclusion of the value of the acquired system's assets in its proposed rate base. Because the documents obtained from the seller may be incomplete and may result in an inaccurate valuation, the acquiring utility will not be bound by the incomplete documents from the seller in the preparation of its original cost plant-in-service valuation.

(iii) *Procedure for booking CIAC.* The acquiring utility, at a minimum, should book as CIAC contributions that were properly recorded on the books of the system being acquired. If evidence supports other CIAC that was not booked by the seller, the acquiring utility should make a documented effort to determine the actual CIAC and record the contributions for ratemaking purposes, such as lot sale agreements or capitalization vs. expense of plant-in-service on tax returns.

(iv) *Plant retired/not booked/not used and useful.* The acquiring utility should identify all plant retirements and plant no longer used and useful, and complete the appropriate accounting entries.

(v) *Reconciliation with commission records.* In the case of an acquisition of a water or wastewater system that is regulated by the Commission, the acquiring utility should reconcile and explain any discrepancies between the acquiring utility's original cost plant-in-service valuation and the Commission's records, to the extent reasonably known and available to the acquiring utility, at the same time the supporting documentation for the study is filed.

(e) *Time to submit original cost valuation.* When the acquiring utility elects to request an acquisition adjustment during its next rate filing, it should submit a copy of its newly prepared original cost plant-in-service valuation of the acquired system or a statement of reliance of the existing records of the Commission or the seller to the Commission's Secretary's Bureau, the Bureau of Audits, the Bureau of Fixed Utility Services, the Office of Trial Staff, the Office of Consumer Advocate, and the Office of Small Business Advocate at least 4 months prior to the date that the acquiring utility plans to make its next rate case filing with the Commission.

(1) The Commission staff may conduct an audit of the original cost valuation, but if no staff audit is completed and released at public meeting before the date of the rate case filing, the Commission's determination of the original cost valuation in the rate case will be deemed final action on the original cost valuation and any associated acquisition adjustment, absent subsequently discovered fraud or misrepresentation. When staff completes an audit before the rate case is filed, the results of the audit will not be binding on any party, but rather the audit report will be made available to the public and the report can be presented in the acquiring utility's next rate case, subject to applicable evidentiary rules.

(2) When the acquiring utility makes a rate case filing sooner than the 4-month window, the acquiring utility should not include any revenues or expenses related to the acquisition, including the requested acquisition adjustment in its proposed rate base unless it includes the original cost valuation with the rate filing and one of the following circumstances applies:

(i) A compelling reason exists for requesting the acquisition adjustment in the current rate filing.

(ii) The acquisition was requested or otherwise directed by the Commission.

(iii) No statutory party objects to the inclusion of the acquisition adjustment to the proposed rate base of the acquiring utility.

(f) *Purchase price of the water and wastewater system.* The factors relevant to the reasonableness of the purchase price of the acquired water and wastewater system include:

(1) Promotion of long-term viability.

(2) Promotion of regionalization.

(3) Usage per customer.

(4) Growth rates.

(5) Cost of improvements.

(6) Age of the infrastructure.

(7) Return on equity.

(8) Existing rates.

(9) Purchase price per customer.

Adopted Mar. 30, 1996; Amended Feb. 14, 1998; Amended Sept. 30, 2006; Amended Sept. 29, 2006.

52 Pa. Code § 69.711, 52 PA ADC § 69.711

Current through Pennsylvania Bulletin, Vol. 41, Num. 24, dated June 11, 2011.

END OF DOCUMENT

C

West's Pennsylvania Administrative Code Currentness
Title 52. Public Utilities
Part I. Public Utility Commission
Subpart C. Fixed Service Utilities
Chapter 69. General Orders, Policy Statements and Guidelines on Fixed Utilities
Acquisitions of Viable Water and Wastewater System--Statement of Policy

→ **§ 69.721. Water and wastewater system acquisitions.**

(a) *General.* The Commission believes that further consolidation of water and wastewater systems within this Commonwealth may, with appropriate management, result in greater environmental and economic benefits to customers. The regionalization of water and wastewater systems through mergers and acquisitions will allow the water industry to institute better management practices and achieve greater economies of scale. To further this goal, the Commission sets forth the guidance in this section regarding the acquisition of water and wastewater systems. Guidance specifically applicable to the acquisition of nonviable systems is set forth in § 69.711 (relating to acquisition incentives).

(b) *Inclusion of acquisition assets in rate base.* After the approval of an acquisition, as evidenced by the receipt of a certificate of public convenience, an acquiring utility may request the inclusion of the value of the used and useful assets of the acquired system in its rate base. A request will be considered during the acquiring utility's next filed rate case proceeding. See 66 Pa.C.S. § 1311(a) (relating to valuation of and return on the property of a public utility).

(c) *Method of valuation of acquisition assets.* The assets of the acquired system should be booked at the original cost of the acquired system when first devoted to the public service less the applicable accrued depreciation and related contributions. See 66 Pa.C.S. § 1311(b).

(d) *Determining original cost of acquisition assets.* An acquiring utility may use various methods to support its valuation of the original cost of the used and useful assets of the acquired water or wastewater system. For example, an acquiring utility may elect to rely in whole or in part upon the original cost records of the seller or the Commission in determining the original cost of the used and useful assets of the acquired system that are to be included in its rate base.

(e) *Preparation of an original cost of plant-in-service valuation.* The Commission will not require an acquiring utility to submit a full original cost plant-in-service study in order to determine the value of the assets of the acquired system. An acquiring utility, upon its own election, may file an original cost study with the Commission to support its valuation of the assets of the acquired water and wastewater system proposed to be included in its rate base. A full original cost plant-in-service study is one method of determining the valuation costs of the property of a public utility. It requires the acquiring utility to develop realistic plant balances and accumulates the records and accounting details that support those balances. Disputes regarding the acquiring utility's original cost valuation of the acquired assets will be resolved in the context of a rate proceeding in which all interested parties will have an opportunity to be heard.

(1) *Contents of an original cost plant-in-service study.* The acquiring utility is obligated to exercise due diligence and make reasonable attempts to obtain, from the seller, documents related to original cost. In particular, as part of its due diligence, the acquiring utility should request from the seller, for purposes of determining the original cost plant-in-service valuation, the original cost of the assets being acquired and records relating to contributions in aid of construction (CIAC), such as the following:

(i) Accounting records and other related documentation and agreements of donations or contributions, services, or property from states, municipalities or other government agencies, individuals, and others for construction purposes.

(ii) Records of unrefunded balances in customer advances for construction (CAC).

(iii) Records of customer tap-in fees and hook-up fees.

(iv) Prior original cost studies.

(v) Records of local, State and Federal grants used for construction of utility plant.

(vi) Relevant PennVEST or Department of Environmental Protection records.

(vii) Any Commission records.

(viii) Summary of the depreciation schedules from all filed Federal tax returns.

(ix) Other accounting records supporting plant-in-service.

(2) *Failure of seller to provide cost-related documents.* The failure of a seller to provide cost-related documents, after reasonable attempts to obtain the data, will not be a basis for the Commission's denial of the inclusion of the value of the acquired system's assets in its proposed rate base. Because the documents obtained from the seller may be incomplete and may result in an inaccurate valuation, the acquiring utility will not be bound by the incomplete documents from the seller in the preparation of its original cost plant-in-service valuation.

(3) *Procedure for booking CIAC.* The acquiring utility, at a minimum, should book as CIAC contributions that were properly recorded on the books of the system being acquired. If evidence supports other CIAC that was not booked by the seller, the acquiring utility should make a documented effort to determine the actual CIAC and record the contributions for ratemaking purposes, such as lot sale agreements or capitalization versus expenses of plant-in-service on tax returns.

(4) *Plant retired/not booked/not used and useful.* The acquiring utility should identify all plant retirements and plant no longer used and useful and complete the appropriate accounting entries.

(5) *Reconciliation with commission records.* In the case of an acquisition of a water or wastewater system that is regulated by the Commission, the acquiring utility should reconcile and explain any discrepancies between the acquiring utility's original cost plant-in-service valuation and the Commission's records, to the extent reasonably known and available to the acquiring utility, at the same time the supporting documentation for the study is filed.

(f) *Time to submit original cost valuation.* When the acquiring utility elects to request inclusion of its acquisition in its rate base, it should submit a copy of its newly prepared original cost plant-in-service valuation of the acquired system or a statement of reliance of the existing records of the Commission or the seller to the Commission's Secretary's Bureau, the Bureau of Audits, the Bureau of Fixed Utility Services, the Office of Trial Staff, the Office of Consumer Advocate and the Office of Small Business Advocate at least 4 months prior to the date that the acquiring utility plans to make its next rate case filing with the Commission.

(1) The Commission staff may conduct an audit of the original cost valuation, but if no staff audit is completed and released at public meeting before the date of the rate case filing, the Commission's determination of the original cost valuation in the rate case will be deemed final action on the original cost valuation, absent subsequently discovered fraud or misrepresentation. When staff completes an audit before the rate case is filed, the results of the audit will not be binding on any party, but rather the audit report will be made available to the public and the report can be

presented in the acquiring utility's next rate case, subject to applicable evidentiary rules.

(2) When the acquiring utility makes a rate case filing sooner than the 4-month window, the acquiring utility should not include any revenues or expenses related to the acquisition, including the requested acquisition adjustment in its proposed rate base unless it includes the original cost valuation with the rate filing and one of the following circumstances applies:

(i) A compelling reason exists for requesting the acquisition in the current rate filing.

(ii) The acquisition was requested or otherwise directed by the Commission.

(iii) No statutory party objects to the inclusion of the acquisition to the proposed rate base of the acquiring utility.

(g) *Acquisition incentives.* In its efforts to foster the acquisitions of smaller, less viable water and wastewater systems by larger more viable systems, the Commission, under 66 Pa.C.S. § 523 (relating to performance factor consideration), has broad latitude to allow the acquiring utility to request a rate of return premium in a subsequent rate case. The allowance of a rate of return premium, as an acquisition incentive for an acquisition that falls outside of the parameters of 66 Pa.C.S. § 1327 (relating to acquisition of water and sewer utilities), may be requested by those utilities that have a demonstrated track record of acquiring and improving the service provided to the customers of smaller and less viable water systems. The allowance of additional rate of return basis points may be awarded based on sufficient supporting data submitted by the utility within its rate case filing.

Adopted Sept. 30, 2006.

52 Pa. Code § 69.721, 52 PA ADC § 69.721

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