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BEFORE THE ARIZONA CORPORATION COMMISSION

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**COMMISSIONERS**

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

DOCKET NO. W-01212A-12-0309

Arizona Corporation Commission

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OCT 18 2013

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

DOCKET NO. SW-20445A-12-0310

IN THE MATTER OF THE APPLICATION OF WATER UTILITY OF NORTHERN SCOTTSDALE, INC. FOR APPROVAL OF A RATE INCREASE.

DOCKET NO. W-03720A-12-0311

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

DOCKET NO. W-02450A-12-0312

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

DOCKET NO. W-02451A-12-0313

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

DOCKET NO. W-20446A-12-0314

6 IN THE MATTER OF THE APPLICATION OF  
7 WILLOW VALLEY WATER COMPANY FOR THE  
8 ESTABLISHMENT OF JUST AND REASONABLE  
9 RATES AND CHARGES FOR UTILITY SERVICE  
10 DESIGNED TO REALIZE A REASONABLE RATE  
11 OF RETURN ON THE FAIR VALUE OF ITS  
12 PROPERTY THROUGHOUT THE STATE OF  
13 ARIZONA.

DOCKET NO. W-01732A-12-0315

**STAFF'S INITIAL BRIEF**

11 The Utilities Division (“Staff”) of the Arizona Corporation Commission (“Commission”)  
12 hereby submits its initial brief in this matter as directed by the Administrative Law Judge (“ALJ”) on  
13 September 12, 2013.<sup>1</sup> Staff urges the Commission to approve the Settlement Agreement  
14 (“Agreement”) that was filed on August 13, 2013. The Agreement helps restore the financial health  
15 of the Company, resolves issues attendant to the Infrastructure Coordination and Financing  
16 Agreements (“ICFA” or “ICFAs”) and provides just and reasonable rates to the customers of the  
17 utilities. The Agreement proposes a solution that otherwise would not be obtainable in a litigated  
18 case and is fair and balanced and in the public interest. Staff also recommends that the Commission  
19 approve the System Improvement Benefit (“SIB”) mechanism for the Willow Valley Water Company  
20 (“Willow Valley”).

21 **I. INTRODUCTION.**

22 On July 9, 2012, Palo Verde Utilities Company (“Palo Verde”), Santa Cruz Water Company  
23 (“Santa Cruz”), Valencia Water Company – Town Division (“Town Division”), Valencia Water  
24 Company – Greater Buckeye Division (“Buckeye”), Water Utility of Greater Tonopah, Inc.  
25 (“WUGT”), Willow Valley and Water Utility of Northern Scottsdale, Inc. (“WUNS” or “Northern  
26 Scottsdale”) (collectively “Global Applicants” or “Company”) filed applications for rate increases,  
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<sup>1</sup> Tr. Vol. IV at 735.

1 and subsequently filed several amendments. The ALJ ultimately consolidated the applications on  
2 November 20, 2012.

3 The Commission authorized the current rates for Town Division, Palo Verde, WUGT,  
4 Buckeye, Santa Cruz and Willow Valley in Decision No. 71878 on September 15, 2010, as follows:

5 Town Division – The Commission authorized a \$1,473,012 or 48.49 percent revenue  
6 increase that provided a 8.08 percent fair value rate of return on \$4,240,018 fair value  
rate base.<sup>2</sup>

7 Palo Verde – The Commission authorized a \$6,063,392 or 91.26 percent revenue  
8 increase that provided a 7.80 percent fair value rate of return on a \$53,314,083 fair  
value rate base.<sup>3</sup>

9 WUGT – The Commission authorized a (\$24,283) or 9.36 percent revenue decrease  
10 that provided a 7.82 percent operating margin. The rates were set using an operating  
margin due to WUGT having negative rate base of \$4,186,150.<sup>4</sup>

11 Buckeye – The Commission authorized a \$77,259 or 20.31 percent revenue increase  
12 that provided a 7.68 percent fair value rate or return on a \$929,057 fair value rate  
base.<sup>5</sup>

13 Santa Cruz – The Commission authorized a \$1,542,323 or 16.39 percent revenue  
14 increase that provided a 7.93 percent fair value rate of return on a \$39,155,692 fair  
value rate base.<sup>6</sup>

15 Willow Valley – The Commission authorized a \$428,047 or 90.40 percent revenue  
16 increase that provided a 7.60 percent fair value rate of return on a \$2,251,164 fair  
value rate base.<sup>7</sup>

17 Finally, the Commission authorized the current rates for WUNS in Decision No. 70562. In  
18 that decision, the Commission authorized a \$35,108 or 40.01 percent revenue increase that provided a  
19 13.01 percent operating margin.<sup>8</sup> The Commission set rates using an operating margin due to WUNS  
20 having negative rate base that was not useful in setting rates.<sup>9</sup>

21 In this case, the Global Applicants sought significant rate increases ranging from a low of  
22 0 percent for WUNS to a high of 326.16 percent for WUGT.<sup>10</sup> In their applications, the Global  
23  
24

25 <sup>2</sup> Decision No. 71878 at 58.

26 <sup>3</sup> *Id.* at 57.

27 <sup>4</sup> *Id.* at 58.

28 <sup>5</sup> *Id.* at 57.

<sup>6</sup> *Id.* at 57.

<sup>7</sup> *Id.* at 57.

<sup>8</sup> Decision No. 70562 at 7.

<sup>9</sup> *Id.* at 7.

<sup>10</sup> Becker Direct, Ex. S-1 at 7.

1 Applicants requested a total revenue increase of \$8,437,770 or approximately 28.10 percent over  
2 their current revenues of \$30,031,217, using a test year ending December 31, 2011.<sup>11</sup>

3 The impact of the Global Applicants' request on each system is as follows:

4 Town Division – A revenue increase of \$823,424 or 16.67 percent over proposed test  
5 year revenues of \$4,940,316 to \$5,763,740. This proposed revenue increase would  
6 produce an operating income of \$238,621 for a 10.27 percent rate of return on fair  
7 value rate base of \$2,323,475.<sup>12</sup>

8 Palo Verde – A revenue increase of \$3,662,560 or 27.94 percent over proposed test  
9 year revenues of \$13,107,528 to \$16,770,088. This proposed revenue increase would  
10 produce an operating income of \$5,300,691 for an 8.81 percent rate of return on fair  
11 value rate base of \$60,166,756.<sup>13</sup>

12 WUNS – WUNS proposes no changes to its revenue of \$147,513. This existing  
13 revenue amount produces an operating margin of 14.44 percent.<sup>14</sup>

14 WUGT – A revenue increase of \$677,458 or 326.16 percent over proposed test year  
15 revenues of \$207,705 to \$885,163. This proposed revenue increase would produce an  
16 operating income of \$236,637 for a 10.72 percent rate of return on fair value rate base  
17 of \$2,206,816.<sup>15</sup>

18 Buckeye – A revenue increase of \$36,423 or 7.88 percent over proposed test year  
19 revenues of \$462,043 to \$498,466. This proposed revenue increase would produce an  
20 operating income of \$70,975 for an 11.18 percent rate of return on fair value rate base  
21 of \$634,979.<sup>16</sup>

22 Santa Cruz – A revenue increase of \$2,730,367 or 26.09 percent over proposed test  
23 year revenues of \$10,463,460 to \$13,193,827. This proposed revenue increase would  
24 produce an operating income of \$3,342,866 for an 8.79 percent rate of return on fair  
25 value rate base.<sup>17</sup>

26 Willow Valley – A revenue increase of \$507,538 or 72.23 percent over proposed test  
27 year revenues of \$702,652 to \$1,210,190. This proposed revenue increase would  
28 produce an operating income of \$250,024 for a 10.60 percent rate of return on fair  
value rate base of \$2,359,391.<sup>18</sup>

29 These requested increases were based on an 11.44 percent return on equity.<sup>19</sup> The Company  
30 proposed to use the actual capital structures for Town Division, Buckeye, Willow Valley, WUGT,  
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34 <sup>11</sup> Becker Direct, Ex. S-1 at 8.

35 <sup>12</sup> *Id.* at 8.

36 <sup>13</sup> *Id.* at 8.

37 <sup>14</sup> *Id.* at 8.

38 <sup>15</sup> *Id.* at 9.

39 <sup>16</sup> *Id.* at 9.

40 <sup>17</sup> *Id.* at 9.

41 <sup>18</sup> *Id.* at 9.

42 <sup>19</sup> Rowell Direct, Ex. A-26 at 2.

1 and WUNS, and sought to continue the imputation of the Industrial Development Authority (“IDA”)  
2 bonds for Palo Verde and Santa Cruz.

3 The Global Applicants asserted that their requested increases are due to a number of factors.  
4 The Company asserts that the Global Applicants have made significant investments in rate base since  
5 the last rate case and that expenses have increased. Beyond what amounts to the typical reasons a  
6 utility files an application for a rate increase, the Company also indicates that the 9.0 percent return  
7 on equity (“ROE”) the Commission authorized in the Company’s last rate case contributed to the  
8 requested increases. However, it appears that the overriding reason for the Company filing the  
9 applications relates to the Commission’s ratemaking treatment of the monies received pursuant to the  
10 ICFAs. More specifically, the Company asserted that the Commission’s treatment of ICFA revenues  
11 as Contributions in Aid of Construction (“CIAC”) ultimately caused an \$85 million net loss for the  
12 Company in 2010. The Global Applicants sought to reverse this treatment in this case for reasons  
13 discussed during the Commission’s 2011 water workshops.<sup>20</sup>

14 In its applications, the Company also stipulated to a cap on rate increases of approximately  
15 5 percent per year for the median residential customer in Santa Cruz and Palo Verde.<sup>21</sup> The  
16 Company also sought to continue the rate design authorized in Decision No. 71878 that included a  
17 rebate threshold.<sup>22</sup> The Company also requested approval of an adjustor mechanism for the Central  
18 Arizona Groundwater Replenishment District (“CAGRD”) fees for WUGT.<sup>23</sup> Further, the Company  
19 sought to include post-test year plant of \$672,571, \$818,395, \$106,782, \$306,892, and \$80,436 for  
20 Town Division, Palo Verde, WUGT, Santa Cruz, and Willow Valley, respectively.<sup>24</sup> The Global  
21 Applicants sought continuation of tariffs that the Commission approved in prior rate cases except for  
22 the Best Management Practices (“BMP”) tariffs, and sought to extend the Low Income Tariff,  
23 Customer Meter Exchange Tariff, and Hydrant Meter Tariff to WUNS.<sup>25</sup> In addition, the Company

26 <sup>20</sup> Company Application, Ex. A-1 at 2.

27 <sup>21</sup> Hill Direct, Ex. A-9 at 3.

28 <sup>22</sup> *Id.* at 4.

<sup>23</sup> Fleming Direct, Ex. A-10 at 16.

<sup>24</sup> *Id.* at 20-21.

<sup>25</sup> *Id.* at 33.

1 requested approval of a Terms and Conditions Tariff and an Individual Case Basis (“ICB”) tariff for  
2 each of the Global Applicants.<sup>26</sup>

3 A number of parties have been granted intervention in this proceeding including the  
4 Residential Utility Consumer Office (“RUCO”), New World Properties, Inc. (“NWP”), the City of  
5 Maricopa (“Maricopa”), Maricopa Area Homeowners Associations (“Maricopa HOAs”)<sup>27</sup>, Steven  
6 Tardiff, the Willow Valley Club Association (“WVCA”), Dana Jennings, Andy and Marilyn  
7 Mausser, and Sierra Negra Ranch (“SNR”). Staff also requested that Global Water Resources, Inc.,  
8 Hassayampa Utilities Company (“HUC”), Picacho Cove Water Company, and Picacho Cove Utilities  
9 Company (collectively “Global Intervenors”) intervene in this matter.<sup>28</sup> The Global Intervenors were  
10 ultimately granted intervention on July 18, 2013.<sup>29</sup>

11 Staff recommended adjustments to the Global Applicants’ rate bases related to the  
12 disallowance of post test year plant of \$353,978, \$543,461, and \$80,436 for Town Division, Palo  
13 Verde, and Willow Valley, respectively.<sup>30</sup> The largest impact to rate base related to the regulatory  
14 treatment of the payments the Company received pursuant to the ICFAs. Staff proposed that only a  
15 portion of those funds received be treated as CIAC in this case, i.e., an amount equal to an equivalent  
16 hook up fee (“HUF” or “HUFs”).<sup>31</sup> This resulted in a total rate base reduction of \$23,580,646 with  
17 \$10,718,719 reduced from Palo Verde, \$10,395,549 reduced from Santa Cruz, and \$2,466,378  
18 reduced from WUGT.<sup>32</sup> In addition, Staff recommended that Global be required to establish a HUF  
19 for each of the Global Applicants and fund those HUFs, for those developers that have signed ICFAs,  
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23 <sup>26</sup> Fleming Direct, Ex. A-10 at 35, 37.  
24 <sup>27</sup> The represented HOAs are: Acacia Crossings Homeowners Association (“Acacia”), Alterra Homeowners Association  
25 (“Alterra”), Cobblestone Farms Homeowners Association (“Cobblestone”), Desert Cedars Homeowners Association  
26 (“Desert Cedars”), Desert Passage Community Association (“Desert Passage”), Glennwilde Homeowners’ Association  
27 (“Glennwilde”), Homestead North Homeowners’ Association (“Homestead North”), Maricopa Meadows Homeowners  
28 Association (“Maricopa Meadows”), Province Community Association (“Province”), Rancho El Dorado Homeowners’  
Association (“Rancho El Dorado”), Rancho El Dorado Phase III Homeowners Association (“Rancho El Dorado III”),  
Rancho Mirage Master Planned Community Homeowners Association (“Rancho Mirage”), Senita Community  
Association (“Senita”), and Sorrento Community Master Association (“Sorrento”).  
<sup>28</sup> Armstrong Dir., Ex. S-2 at 23.  
<sup>29</sup> July 18, 2013 Procedural Order.  
<sup>30</sup> Becker Direct, Ex. S-1 at 14.  
<sup>31</sup> Armstrong Direct, Ex. S-2 at 24.  
<sup>32</sup> *Id.*

1 using monies received in the future pursuant to the ICFAs.<sup>33</sup> Finally, Staff recommended that the  
2 Company cease entering into new ICFAs.<sup>34</sup>

3 Staff also recommended a number of adjustments to the operating expenses of the Global  
4 Applicants relating to Purchased Power, Chemicals, Bad Debt Expense, Rate Case Expense, Salaries  
5 and Wages, Materials and Supplies, Outside Services/Contractual Services – Professional,  
6 Miscellaneous Expenses, Contractual Services – Testing, Depreciation Expense, and Income Tax  
7 Expense.<sup>35</sup>

8 Staff recommended the use of a consolidated capital structure for the Global Applicants  
9 consisting of 57.8 percent debt and 42.2 percent equity and a return on equity of 9.4 percent.<sup>36</sup>  
10 Staff's adjustments and proposed cost of capital resulted in a revenue increase of \$532,023.<sup>37</sup> For  
11 each of the Global Applicants Staff recommended the following:

12 Town Division – For Town Division Staff recommended a revenue increase of  
13 \$34,665 or .70 percent over the test year revenue of \$4,940,316 to \$4,974,981. This  
14 proposed increase would have produced an operating income of \$147,712 for a 7.50  
percent rate of return on fair value rate base of \$1,969,496.<sup>38</sup>

15 Palo Verde – For Palo Verde Staff recommended a revenue increase of \$149,593 or  
16 1.14 percent over test year revenues of \$13,107,528 to \$13,257,121. This proposed  
revenue increase would have produced an operating income of \$3,667,843 for a 7.50  
percent fair value rate of return on a fair value rate base of \$48,904,575.<sup>39</sup>

17 WUNS – For WUNS Staff recommended no change to its revenue of \$147,513. This  
18 proposed revenue would have produced an operating margin of 15.91 percent based  
19 on an operating income of \$23,472. WUNS has a negative rate base that was not  
useful in setting rates.<sup>40</sup>

20 WUGT – For WUGT Staff recommended a revenue increase of \$199,983 or 96.28  
21 percent over test year revenues of \$207,705 to \$407,689. This proposed revenue  
22 increase would have produced an operating income of \$40,786 and a 10 percent  
operating margin. WUGT also had negative rate base that was not useful in setting  
rates.<sup>41</sup>

23 Buckeye – For Buckeye Staff recommended a revenue increase of \$8,912 or 1.93  
24 percent over test year revenues of \$462,043 to \$470,955. The proposed revenue

25 <sup>33</sup> Armstrong Direct, Ex. S-2 at 20.

26 <sup>34</sup> *Id.*

27 <sup>35</sup> Becker Direct, Ex. S-1 at 11-13.

28 <sup>36</sup> Cassidy Direct, Ex. S-4 at 8, 40.

<sup>37</sup> Becker Direct, Ex. S-1 at 7.

<sup>38</sup> *Id.* at 8.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* at 9.

1 increase would produce an operating income of \$47,623 for a 7.50 percent fair value  
rate of return on a fair value rate base of \$634,979.<sup>42</sup>

2 Santa Cruz – For Santa Cruz Staff recommended a revenue decrease of \$265,199 or  
3 2.53 percent less than the test year revenues of \$10,198,261. This proposed revenue  
4 decrease would have produced an operating income of \$2,071,402 for a 7.50 percent  
fair value rate of return on fair value rate base of \$27,618,694.<sup>43</sup>

5 The Company filed an initial notice of settlement discussions on July 11, 2013, and a revised  
6 notice of settlement discussions on July 15, 2013. The parties of record participated in settlement  
7 discussions on July 18 and 19, 2013.<sup>44</sup> Staff, RUCO, Global Applicants, Global Intervenors,  
8 Maricopa, and Maricopa HOAs<sup>45</sup> reached a settlement and Staff filed the Agreement on August 13,  
9 2013. NWP, SNR, and WVCA are the only parties that participated in the settlement discussions that  
10 did not sign the Agreement. The Agreement resolves all outstanding issues except the Company’s  
11 request for a SIB mechanism, which was specifically excluded from the Agreement and was to be  
12 subsequently litigated by the parties. Staff believes that the terms of the Agreement are just,  
13 reasonable, fair, and in the public interest and that the Agreement results in a settlement that provides  
14 just and reasonable rates and properly balances the interests of the ratepayers, the Company and all  
15 parties in the docket.

16 **II. SETTLEMENT AGREEMENT OVERVIEW.**

17 **A. Settlement Agreement Benefits.**

18 The Global Applicants have extensive service territories in western Maricopa County, Pinal  
19 County, and Mohave County serving approximately 40,000 customers. As indicated above, one of  
20 the biggest issues that prompted the Company to file the applications on behalf of the Global  
21 Applicants was the financial impact the Commission’s treatment of the ICFAs had on the Company.  
22 In particular, the Company asserts that the “last rate case had disastrous results for our company – we  
23 wound up with an \$85 million net loss in 2010 as a result of the Commission’s decision to disregard  
24 acquisition costs and assign every dollar of developer funding to plant....”<sup>46</sup> As a result, the  
25 Company asserts that it has nearly \$300 million in plant but only about \$100 million in rate base,

26 <sup>42</sup> Becker Direct, Ex. S-1 at 9.

27 <sup>43</sup> *Id.*

28 <sup>44</sup> Steven Tardiff, Dana Jennings, Andy and Marilyn Mausser were notified of the settlement discussions but did not  
participate. Olea Settlement Test., Ex. S-5 at 5.

<sup>45</sup> Desert Passage Community Association has not signed the Settlement Agreement.

<sup>46</sup> Hill Direct, Ex. A-9 at 5.

1 which is not sustainable.<sup>47</sup> The Agreement addresses this issue, but does so in a way that ultimately  
2 is in the public interest. Benefits of the Agreement include:

- 3 • A phase-in of rates with no rate increase in year one of the phase-in for any of  
4 the Global Water and Wastewater Utilities;
- 5 • An overall rate phase-in for Santa Cruz and Palo Verde over a period of 8  
6 years with the effects of the ICFA de-imputation over 7 years starting in year  
7 2 and the effects of expense recovery over 2 years starting in year 2;
- 8 • A rate phase-in for Valencia Town, Valencia Buckeye, Willow and Tonopah  
9 over a period of 3 years;
- 10 • A phase-in of rate increase attributable to recovery of expenses in years 2 and  
11 3 of the phase-in;
- 12 • There will be no change in revenue requirement for WUNS as a result of this  
13 case;
- 14 • The Global Water and Wastewater Utilities originally agreed to a rate stay-out  
15 until May 31, 2016; but with the City of Maricopa signing the Agreement, the  
16 stay-out is extended to May 31, 2017 for Santa Cruz and Palo Verde;
- 17 • Continuing bill assistance for low income customers in existing Global  
18 Utilities with such programs, and expansion of the low income bill assistance  
19 program into the other Global Utilities;
- 20 • The rate design will allow customers an opportunity to reduce their bill by  
21 providing a rebate when customers use less than the Conservation Rebate  
22 Threshold ("CRT"); and
- 23 • Resolution of issues regarding the ICFAs.<sup>48</sup>

24 The Agreement in this case is designed to restore Global Parent's balance sheet while, at the  
25 same time, not unduly burdening the customers of the Global Applicants. As mentioned above, the  
26 Agreement was signed by all but two of the active participants in these consolidated matters.<sup>49</sup> The  
27 Agreement is the result of several days of transparent settlement discussions between parties with  
28 divergent interests. Staff believes that the Agreement addresses the Company's concerns resulting  
from Decision No. 71878 on the one hand while protecting ratepayers from the effects of modifying  
the treatment of ICFAs in this case and the resulting rate increases for the Global Applicants.

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27 <sup>47</sup> Hill Direct, Ex. A-9 at 5.  
28 <sup>48</sup> Settlement Agreement, Ex. A-17.  
<sup>49</sup> WVCA, Dana Jennings, Steven Tardiff, and Andy and Marilyn Mausser did not participate in the hearings in this matter.

1 **III. THE SETTLEMENT AGREEMENT IS IN THE PUBLIC INTEREST.**

2 The Agreement the Signatory Parties reached resolves all issues in these consolidated matters  
3 with the exception of the SIB mechanism, which the parties agreed would be separately litigated and  
4 left to the ALJ and, ultimately, the Commission to decide.<sup>50</sup> The Signatory Parties, each in their own  
5 way, have indicated that adoption of the Agreement by the Commission is in the public interest.<sup>51</sup>  
6 Steve Olea, Utilities Division Director, testified that the Agreement is fair, balanced and in the public  
7 interest.<sup>52</sup> He further stated that the Agreement results in a settlement package that addresses the  
8 needs of the Global Applicants, Global Parent, and other Global utilities while balancing those needs  
9 with terms and conditions that provide significant consumer benefits.<sup>53</sup>

10 Ron Fleming from Global also supports the settlement and requests that the Commission  
11 approve it.<sup>54</sup> Mr. Fleming asserted that the Agreement satisfies the Company's two principles of  
12 restoring the Global Parent's balance sheet while protecting customers.<sup>55</sup>

13 Maricopa's representative, Mr. Jepson, testified that Commission approval of the Agreement  
14 would be in the best interest of the rate payers of Santa Cruz, Palo Verde and the City.<sup>56</sup> Mr. Jepson  
15 testified that the Agreement addressed Maricopa's concerns regarding the significant rate increase  
16 that Santa Cruz and Palo Verde were requesting, and that the resolution of issues relating to the  
17 ICFAs was consistent with the June 23, 2001, City of Maricopa Resolution No. 11-40.<sup>57</sup>

18 Similarly, the Maricopa HOAs were interested in the water and sewer rates that are applicable  
19 to the Maricopa HOAs and their members and, in particular, the water rates for outdoor potable water  
20 use, raw groundwater, and effluent rates.<sup>58</sup> Ms. Hilliard, appearing on behalf of the signing Maricopa  
21 HOAs, testified that the Agreement addressed their concerns with a smaller effluent rate increase that  
22 is phased-in over eight years, and with the resolution of the dispute regarding the treatment of the  
23 ICFAs.<sup>59</sup>

24 <sup>50</sup> Settlement Agreement at 3, Section 1.4.

25 <sup>51</sup> Quinn Direct, Ex. R-5 at 6, Olea Direct, Ex. S-5 at 13, Fleming Direct, Ex. A-42 at 7, Jepson Direct, Ex. City-2 at 4,  
and Hilliard Direct, Ex. MHOA-1 at 7-8.

26 <sup>52</sup> Olea Direct, Ex. S-5 at 13.

<sup>53</sup> *Id.*

<sup>54</sup> Fleming Direct, Ex. A-19 at 7.

<sup>55</sup> *Id.* at 4-6.

27 <sup>56</sup> Jepson Direct, Ex. City-1 at 4.

<sup>57</sup> *Id.*

28 <sup>58</sup> Hilliard Direct, Ex. MHOA-1 at 5.

<sup>59</sup> *Id.* at 8.

1 RUCO also supports the Agreement for several reasons. First, the Agreement finally resolves  
2 all regulatory issue with the ICFAs.<sup>60</sup> Second, the Company reduced its revenue increases compared  
3 to its original applications.<sup>61</sup> Third, the rate design and rate phase-in proposed in the Agreement.<sup>62</sup>  
4 Fourth, RUCO considers the stay-out provision to be a benefit to rate payers.<sup>63</sup> Finally, RUCO  
5 believes the use of an operating margin for WUGT in this case, and the lower of an operating margin  
6 or rate of return is a benefit to ratepayers.<sup>64</sup>

7 **A. Revenue Requirement.**

8 The overall revenue requirements for the Global Applicants, as proposed in the Agreement,  
9 are as follows:

10 Town Division – a revenue increase of \$252,554 or a total revenue requirement of  
11 \$5,192,870. This is a rate increase of 5.11 percent compared to the 16.67 percent  
increase that Town Division sought in its original application.<sup>65</sup>

12 Palo Verde – a revenue increase of \$1,888,939 or a total revenue requirement of  
13 \$14,996,467. This is a rate increase of 14.41 percent compared to the 27.94 percent  
increase that Palo Verde sought in its original application.<sup>66</sup>

14 WUNS – no revenue increase, which results in the existing revenue requirement of  
15 \$147,513.<sup>67</sup>

16 WUGT – a revenue increase of \$199,983 or a total revenue requirement of \$407,689.  
17 This is a rate increase of 96.28 percent compared to the 326.16 percent increase that  
WUGT sought in its original application.<sup>68</sup>

18 Buckeye Division – a revenue increase of \$9,289 or a total revenue requirement of  
19 \$471,331. This is a rate increase of 2.01 percent compared to the 7.88 percent  
increase that Buckeye Division sought in its original application.<sup>69</sup>

20 Santa Cruz – a revenue increase of \$1,556,046 or a total revenue requirement of  
21 \$12,019,506. This is a rate increase of 14.87 percent compared to the 26.10 percent  
increase Santa Cruz sought in its original application.<sup>70</sup>

22 Willow Valley – a revenue increase of \$404,269 or a total revenue requirement of  
23 \$1,106,922. This is a rate increase of 57.53 percent compared to the 72.23 percent  
increase that Willow Valley sought in its original application.<sup>71</sup>

24 <sup>60</sup> Tr. Vol. at 191.

25 <sup>61</sup> *Id.*

26 <sup>62</sup> *Id.* at 191-192.

27 <sup>63</sup> *Id.*

28 <sup>64</sup> *Id.* at 192.

<sup>65</sup> Settlement Agreement, Ex. A-17, Attachment A, Town Division Settlement A-1.

<sup>66</sup> Settlement Agreement, Ex. A-17, Attachment A, Palo Verde Settlement A-1.

<sup>67</sup> Settlement Agreement, Ex. A-17, Attachment A, Water Utility of Northern Scottsdale Settlement A-1.

<sup>68</sup> Settlement Agreement, Ex. A-17, Attachment A, Water Utility of Greater Tonopah Settlement A-1.

<sup>69</sup> Settlement Agreement, Ex. A-17, Attachment A, Buckeye Division Settlement A-1.

<sup>70</sup> Settlement Agreement, Ex. A-17, Attachment A, Santa Cruz Settlement A-1.

1                   **i.           Rate Base and Revenue and Expense Adjustments.**

2           As part of the settlement package, the Company has agreed to the exclusion of all post test  
3 year plant except for the following projects: (1) Palo Verde Lagoon Clean Closure and Conversion  
4 Project; (2) Valencia –Town Bales Fill Line; and (3) Valencia –Town Buena Vista Fill Line.<sup>72</sup> With  
5 the inclusion of this limited post test year plant and the restoration of the rate base in those utilities,  
6 where the ICFA fees were treated as CIAC previously, the rate bases established in the Agreement  
7 are as follows:

8           Town Division – the fair value rate base in the Agreement is \$2,251,949.

9           Palo Verde – the fair value rate base in the Agreement is \$60,166,756.

10          WUNS – the fair value rate base in the Agreement is negative \$181,978 and, as  
11 discussed elsewhere, the rates will continue to be set using an operating margin.

12          WUGT – the fair value rate base in the Agreement is \$2,206,817.

13          Greater Buckeye – the fair value rate base in the Agreement is \$634,979.

14          Santa Cruz – the fair value rate base in the Agreement is \$37,918,570.

15          Willow Valley – the fair value rate base in the Agreement is \$2,278,955.

16          In addition, the Agreement establishes expense levels that are based on the expense levels  
17 recommended by Staff with a minor exception related to the modified depreciation expense that will  
18 use a 10 year life for National Association of Regulatory Utility Commissioners accounts 348 Other  
19 Tangible Plant and 398 Other Tangible Plant.<sup>73</sup>

20                   **ii.           Cost of Capital.**

21          As part of the Agreement, the Company will adopt Staff's proposed consolidated capital  
22 structure that is comprised of 57.80 percent long term debt and 42.20 percent common equity.<sup>74</sup>  
23 Further, the Company has agreed to a 9.5 percent ROE, which is almost 200 basis points lower than  
24 the 11.44 percent ROE that the Company was seeking prior to entering into the Agreement.<sup>75</sup>

27 <sup>71</sup> Settlement Agreement, Ex. A-17, Attachment A, Willow Valley Settlement A-1.

<sup>72</sup> Ex. A-17 at 4 (2.3.2).

<sup>73</sup> Settlement Agreement, Ex. A-17 at 4-5.

<sup>74</sup> *Id.* at 5.

<sup>75</sup> Rowell Direct, Ex. A-14 at 54

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**B. ICFA Treatment.**

**i. Past Treatment of ICFAs and a Path Towards Resolution**

As was established by the Commission in Decision No. 71878, an ICFA agreement is as follows:

An ICFA (Infrastructure Coordination and Financing Agreement) is a voluntary contract between Global Parent and a landowner. These contracts provide for Global Parent to coordinate the planning, financing and construction of off-site water, wastewater and recycled water plant. The Global Utilities will own and operate this plant when construction is complete. Under the ICFAs, Global Parent is responsible for funding both the planning and construction of water, wastewater and recycled water plant. This is a significant investment for Global Parent. The landowners who enter into the ICFAs agree to cooperate with Global Parent’s plant planning and construction process. ICFAs formalize the cooperation between the landowner and Global, but also provide fees which allow Global Parent to impress conservation and consolidation into the regional planning initiatives. These fees are intended to recover a portion of the carrying costs for the very expensive facilities required to implement effective water conservation and, in some cases, to fund Global Parent’s acquisition of existing utilities.<sup>76</sup>

Global Parent has ICFAs that are associated with Palo Verde, Santa Cruz, WUGT, HUC, and Picacho Cove Utilities.

As mentioned above, in Decision No. 71878, the Commission treated all payments that Global Parent received pursuant to the ICFA as CIAC either against active rate base or as supporting excess capacity.<sup>77</sup> However, the Commission also directed Global, Staff and other interested stakeholders to commence a generic investigation and to hold workshops to address whether ICFAs, if properly segregated and accounted for, would be appropriate for use in financing the acquisition of troubled water companies and to cover carrying costs associated with unused regional infrastructure.<sup>78</sup> In addition, the Commission indicated that, although it did not approve Global’s proposed treatment of the ICFA payments in that Order, it did indicate that “in the event that the workshop process leads to recommendations for a different treatment of the ICFAs than in this Order, the Applicants may request review of the ICFAs in accordance with the workshop recommendations in a future rate case.”<sup>79</sup>

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<sup>76</sup> Decision No. 71878 at 12.  
<sup>77</sup> Decision No. 71878 at 30.  
<sup>78</sup> Decision No. 71878 at 84.  
<sup>79</sup> Decision No. 71878 at 84.

1 Staff, the Company and interested stakeholders, in compliance with the Order, held seven  
2 workshops on various topics from November 2010 through November 2011. During that time, on  
3 June 24, 2011, a workshop was held to address the ICFAs.<sup>80</sup> Ultimately, on March 19, 2012, Staff  
4 issued a Staff Report that addressed the various topics that were covered in the workshops. In that  
5 Staff Report, Staff recommended that monies received pursuant to the ICFAs continue to be treated  
6 as CIAC. However, the report suggested that this recommendation could be modified as a result of  
7 the pending review of Global's ICFAs by an independent CPA firm.<sup>81</sup> At the Commission's  
8 direction, Staff retained a CPA firm to review the ICFAs and determine whether the ICFAs allow for  
9 the ICFA funds to be spent on acquisitions of utilities by Global Parent, and to determine whether the  
10 ICFA funds were used, in whole or in part, to fund acquisition payments and offset acquisition  
11 premiums.<sup>82</sup>

12 Ullmann and Company P.C. completed its review of the ICFAs and issued a report in  
13 November 2012.<sup>83</sup> The Company asserts that the report demonstrates that Global Parent did have its  
14 own debt and equity to finance its investment in plant.<sup>84</sup> Staff also agrees that the report showed that  
15 Global Parent had enough monies to finance its investment in plant without using ICFA fund, except  
16 for a small portion.<sup>85</sup> Whether or not the Company used their own funds however, is not clear. Thus  
17 although Staff and the Company are not in complete agreement as to what the report demonstrates,  
18 both acknowledge that the findings provide support for de-imputing the CIAC treatment of the ICFA  
19 funds in this case.<sup>86</sup> Further, the parties do agree that the Commission has been grappling with the  
20 ICFAs since 2006, and that it is in the best interest of all parties involved to reach a resolution on the  
21 past, present and future treatment of ICFAs.

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26 <sup>80</sup> Staff Report, Docket No. W-20445A-09-0077 et al. dated March 19, 2012.

27 <sup>81</sup> *Id.* at 5.

28 <sup>82</sup> Ullman Report, Ex. A-32 at 2-7.

<sup>83</sup> Ex. A-32.

<sup>84</sup> Paul Walker Settlement Testimony at 9.

<sup>85</sup> Tr. Vol. IV at 718-721.

<sup>86</sup> Tr. Vol. IV at 719-720.

1                   ii.     **The Agreement Comprehensively Addresses the Past, Present, and Future**  
2                   **Ratemaking Treatment of Payments Received Pursuant to the ICFA**  
3                   **Agreements.**

4                   Section VI of the Agreement comprehensively addresses the past, present, and future  
5                   treatment of ICFAs. As part of this settlement package, Global Parent has agreed that it, as well as  
6                   any and all affiliates, will not enter into any new ICFAs or ICFA type agreement.<sup>87</sup> In addition, the  
7                   Global Applicants, HUC, Picaho Water, and Picacho Utilities will establish HUFs as follows for  
8                   each water or wastewater service connection:

9                   Santa Cruz, Palo Verde, Picacho Water, Picacho Utilities - \$1,250<sup>88</sup>

10                  Town Division, Buckeye, WUGT, Willow, WUNS, and HUC - \$1,750<sup>89</sup>

11                  As part of the HUFs, each of the Global Utilities will be required to maintain separate bank  
12                  accounts for all funds received under the HUF tariff and to provide annual reports as required by the  
13                  tariffs.<sup>90</sup> Further, Global's Chief Executive Officer or Chief Financial Officer will have to file an  
14                  affidavit annually that indicates these conditions have been met. During the hearing, the Company  
15                  further agreed to file an annual affidavit attesting to the Company's compliance in the prior year with  
16                  all provisions of the Agreement for which there is a compliance obligation.<sup>91</sup>

17                  In addition, the Company agreed to the continued use of main extension agreements in  
18                  accordance with Commission rules and that any funds or infrastructure used to provide water or  
19                  wastewater service will be segregated to or owned by the appropriate regulated utility.<sup>92</sup>

20                  The Agreement also addresses the treatment of past funds that Global Parent received  
21                  pursuant to the existing ICFAs. To reiterate, the Company has indicated that the manner in which the  
22                  Commission treated the funds received pursuant to the ICFAs in the last rate case had a detrimental  
23                  effect on Global's consolidated balance sheet. Specifically, the Company asserts that for the year  
24                  2010 the Company reported an \$85 million net loss on its income statement, \$79 million of which  
25                  was attributable to the decision in the last rate case to impute all of the ICFA funds as CIAC and  
26                  inclusive of a goodwill impairment charge that was partially triggered by reduced expected revenues

27                  <sup>87</sup> Settlement Agreement, Ex. A-17 at 6.

28                  <sup>88</sup> *Id.* at 10.

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

<sup>91</sup> Tr. Vol. III at 517.

<sup>92</sup> Settlement Agreement, Ex. A-17 at 7.

1 from WUGT.<sup>93</sup> The Company further states that this was a major blow to the Company's  
2 consolidated balance sheet that ultimately caused Global Parent to move into an accumulated deficit  
3 within the equity section of the balance sheet. It is clearly important to the Company that it be  
4 provided with the opportunity for a healthy balance sheet. Staff was also concerned, based on  
5 comments and information from the Company, that the negatively affected balance sheet could have  
6 a negative effect on the ability of the Global Applicants and all Global affiliated utilities to provide  
7 service to customers.<sup>94</sup> Staff believes that the Agreement provides a mechanism to restore the  
8 Company's balance sheet without unduly burdening the ratepayers.<sup>95</sup> The Agreement "de-imputes"  
9 the CIAC treatment of the past ICFA funds as follows:

10 The total amounts that were imputed as CIAC against the active rate base of Santa  
11 Cruz and Palo Verde, as set forth in Exhibit B of Decision No. 71878, will be  
12 reversed and restored to rate base with \$10,323,747 being restored to the rate base of  
13 Palo Verde, and \$6,105,227 being restored to the rate base of Santa Cruz.<sup>96</sup> In order  
to limit the impact of the restoration to these rate bases, they will be phased-in over  
eight years with zero being restored in year one.<sup>97</sup>

14 In Decision No. 71878, \$32,391,318 of the payments that Global received through the ICFAs  
15 was attributed to the Southwest Plant, which was Plant Held for Future Use, as CIAC. In the  
16 Agreement the \$32,391,318 will no longer be reflected as CIAC or CIAC reserve.<sup>98</sup> However, this  
17 reversal of treatment from CIAC or CIAC reserve will have no impact on rates in this case because  
18 the plant is not currently serving customers and is not used and useful.<sup>99</sup> In addition, the Company  
19 cannot seek to include this plant until after the conclusion of the stay-out period of May 31, 2017.<sup>100</sup>  
20 Further, the value of this plant will be restored over the same eight year period that the active rate  
21 base of Palo Verde and Santa Cruz are restored and, when the Company ultimately seeks to include  
22 this plant in rate base, it shall be the lesser of the phased-in amount or the amount determined to be  
23 used and useful by the Commission.<sup>101</sup>

25 <sup>93</sup> Fleming Settlement, Ex. A-19 at 5.

26 <sup>94</sup> Olea Settlement Test. Ex. S-5 at 10.

27 <sup>95</sup> *Id.*

28 <sup>96</sup> Settlement Agreement, Ex. A-17 at 7.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> Tr. Vol. III at 461-462; Settlement Agreement, Ex. A-17 at 8.

<sup>101</sup> Settlement Agreement, Ex. A-17 at 8.

1 The total amounts imputed as CIAC against the active rate base of WUGT, as set forth in  
2 Exhibit B of Decision No. 71878, will be reversed and restored to rate base with \$7,085,645 being  
3 restored.<sup>102</sup> This restoration will have no revenue impact because the rates will be set on an operating  
4 margin.<sup>103</sup> Further, the restoration will be phased-in over eight years and, in any subsequent rate  
5 cases filed within that eight year phase-in, the rates will be set on the lower of a rate of return or 10  
6 percent operating margin.<sup>104</sup>

7 The \$2,140,455 of ICFA funds that were allocated to HUC, as set forth in Exhibit B to  
8 Decision No. 71878, as CIAC reserve will be reversed. This will have no impact because HUC has  
9 no customers and no rate base.<sup>105</sup>

10 The \$500,000 of ICFA funds that were allocated to Picacho Cove Utilities, as set forth in  
11 Exhibit B to Decision No. 71878, as CIAC reserve will be reversed. This will have no impact  
12 because Picacho Cove Utilities does not have any customers or rate base.<sup>106</sup>

13 Finally, through December 31, 2012, the Company has collected \$8,897,600 in ICFA funds  
14 since the December 31, 2008, test year used in the Company's last rate case.<sup>107</sup> The Agreement does  
15 not impute or treat these funds as CIAC.<sup>108</sup>

16 The Agreement also addresses future fees that the Company will receive under the existing  
17 ICFAs.<sup>109</sup> Specifically, for ratemaking purposes, a portion of all ICFA fees that the Company  
18 receives after December 31, 2013, will be paid to the applicable Global Utility as a HUF in the  
19 amount addressed above.<sup>110</sup> The remainder of any ICFA fees may remain with the Global Parent to  
20 be used only in accordance with the terms of the applicable ICFA.<sup>111</sup> Specifically, seventy percent of  
21 each payment that Global Parent receives under the ICFA shall be allocated toward payment of the  
22 HUF and the remaining payment shall be allocated to Global Parent.<sup>112</sup> However, ultimately, Global

23  
24 <sup>102</sup> *Id.*

<sup>103</sup> Settlement Agreement, Ex. A-17 at 8.

<sup>104</sup> *Id.*

<sup>105</sup> *Id.* at 9.

<sup>106</sup> This provision was inadvertently omitted from the Settlement agreement, but Staff and the Company agreed to its inclusion during the hearing. Tr. Vol. III at 397, Tr. Vol. IV at 696.

<sup>107</sup> Settlement Agreement, Ex. A-17 at 9.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> *Id.* at 10.

<sup>112</sup> *Id.*

1 Parent must pay the entire HUF no later than the time the ICFA payment is received for (1) final plat,  
2 (2) the start work date, or (3) the date required by the HUF tariffs that will be established in this case,  
3 whichever is earliest.<sup>113</sup> In an effort to address a concern SNR and NWP have, the Company also  
4 agreed, during the hearing in this matter, to enter into a limited amendment to the ICFA that would  
5 allow a developer who entered into an ICFA to pay the HUF portion directly to the applicable utility  
6 to fund the HUF.<sup>114</sup>

7 Staff believes treatment of the ICFAs as proposed in the Agreement addresses the Company's  
8 concerns while still protecting the ratepayers.

9 **C. Bill Impact and Rate Design.**

10 What is very important to note is there will be no rate increase in the first year, and the Global  
11 Applicants have agreed to waive their right to recover the revenues forgone and/or carrying costs that  
12 are lost as a result of the phase-in.<sup>115</sup> The Agreement proposes that the rate increases for Santa Cruz  
13 and Palo Verde be phased-in over eight years and the rates for the remaining Global Applicants,  
14 except WUNS, be phased-in over three years.<sup>116</sup>

15 The Agreement continues the six tier rate design with a CRT that the Commission approved  
16 in the Company's last rate case and extends this rate design to WUNS. The new CRT threshold will  
17 not take effect until January 1, 2015.<sup>117</sup> Another important provision in the Agreement is that, for  
18 Palo Verde and Santa Cruz, the recycled and nonpotable water rate will be \$1.6380 per 1,000 gallons,  
19 and it will be phased-in over eight years. For the other Global Applicants with no existing recycled  
20 or non-potable water customers, the rate will be \$1.6380 per 1,000 gallons with no phase-in.<sup>118</sup>

21 The typical bill analysis for each of the Global Applicants is as follows:

22 Town Division - Since Town Division does not have any ICFAs, which would be  
23 phased-in over eight years, it has a three year phase-in of rates. A 5/8 inch or 3/4 inch  
24 median usage customer of 5,500 gallons currently has a bill of \$35.16. With the rates  
25 being proposed in this case, this customer's bill would remain the same in 2014,  
during the first year of the three year phase-in. In year two of the phase-in, that same  
customer's bill would increase by a \$1.40 to \$36.56 or a 4 percent increase over

26 <sup>113</sup> *Id.*

27 <sup>114</sup> Tr. Vol. III at 468.

28 <sup>115</sup> *Id.*

<sup>116</sup> Settlement Agreement, Ex. A-17 at 5.

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

1 present rates. Finally, in year three of the phase-in, a median usage customer's bill  
2 would increase by \$1.93 to \$37.09 or a 5.5 percent increase.<sup>119</sup>

3 Palo Verde Sewer – Palo Verde has an eight year phase-in of rates due to the  
4 proposed restoration of the ICFAs in the Agreement. A 5/8 inch or 3/4 inch customer  
5 currently pays \$62.91. This would remain the same for 2014, year one of the phase-  
6 in. In years two through eight the rates would be phased-in, with the cumulative  
7 effect as follows: 2015 – 2.3 percent total increase to \$64.34, 2016 – 4.7 percent total  
8 increase to \$65.88, 2017 – 5.9 percent total increase to \$66.61, 2018 – 7 percent total  
9 increase to \$67.34, 2019 – 8.2 percent total increase to \$68.06, 2020 – 9.3 percent  
10 total increase to \$68.79, and, finally, by 2021 – 10.5 percent total increase to  
11 \$69.53.<sup>120</sup>

12 WUNS – There is no change proposed to the revenue requirement of WUNS and there  
13 is no phase-in of rates.<sup>121</sup> However, the rate design is changed from a three tier with  
14 no CRT to a six tier with a CRT. Currently a one inch meter median usage customer  
15 of 10,500 gallons has a bill of \$116.50. With the changes to rate design proposed in  
16 the settlement, a one inch meter median use customer's bill will remain unchanged in  
17 2014, and will actually decrease by \$6.34 to \$110.16 or 5 percent once the new rate  
18 design goes into effect.<sup>122</sup>

19 WUGT – Although there are ICFAs associated with WUGT, the rates are currently  
20 set on a 7.82 percent operating margin, and as proposed under the Agreement, are set  
21 using a 10% operating margin. Therefore, there is only a three year phase-in of rates  
22 for WUGT. Currently, a 5/8 inch or 3/4 inch customer with a median use of 5,000  
23 gallons has a bill of \$27.58.<sup>123</sup> With the rates being proposed in this case, this  
24 customer's bill would remain the same in 2014 during the first year of the three year  
25 phase-in. In year two of the phase-in, that same customer's bill would increase by  
26 \$10.05 to \$37.63 for a total increase of 36.5 percent. Finally, in year three of the  
27 phase-in, a median usage customer's bill would be \$50.07 or an 81.6 percent total  
28 increase.<sup>124</sup>

Greater Buckeye – Since there are no ICFAs associated with Greater Buckeye, the  
Agreement proposes that the rates for Greater Buckeye be phased-in over three years.  
A 5/8 inch or 3/4 inch customer with a median usage of 6,500 gallons currently has a  
bill of \$37.17.<sup>125</sup> With the rates being proposed in this case, this customer's bill  
would remain the same in 2014, during the first year of the three year phase-in. In  
year two of the phase-in, that same customer's bill would decrease by \$0.36 to \$36.81  
or a 1 percent decrease over present rates. Finally, in year three of the phase-in, a  
median usage customer's bill would increase \$0.07 to \$37.24 or a .2 percent increase  
over present rates.<sup>126</sup>

Santa Cruz – Santa Cruz has an eight year phase-in of rates due to the proposed  
restoration of ICFAs in the Agreement. A 5/8 inch or 3/4 inch customer with a median  
usage of 5,000 gallons currently has a bill of \$31.10.<sup>127</sup> This would remain the same  
in year one of the phase-in. In years two through eight, the rates would be phased-in,

<sup>119</sup> Settlement Agreement, Ex. A-17, Attachment A, Valencia Water Town Division Settlement H4.

<sup>120</sup> Settlement Agreement, Ex. A-17, Attachment A, Palo Verde Sewer Settlement H4.

<sup>121</sup> *Id.* at 5.

<sup>122</sup> *Id.* at Attachment A Water Utility of Northern Scottsdale Settlement H4.

<sup>123</sup> *Id.* at Attachment A, Water Utility of Greater Tonopah Settlement H4. It was noted in the hearing that a number of Willow Valley ratepayers are seasonal. Tr. Vol. V at 756, 763.

<sup>124</sup> *Id.* at Attachment A, Water Utility of Greater Tonopah Settlement H4.

<sup>125</sup> *Id.* at Attachment A, Greater Buckeye Division Settlement H4.

<sup>126</sup> *Id.* at Attachment A, Greater Buckeye Division Settlement H4.

<sup>127</sup> Settlement Agreement, Ex. A-17, Attachment A, Santa Cruz Settlement H4.

1 with the cumulative effect as follows: 2015 – increase \$1.36 to \$32.46 or 4.4 percent  
2 total increase, 2016 – increase \$2.11 to \$33.21 or 6.8 percent total increase, 2017 –  
3 increase \$2.34 to \$33.44 or 7.5 percent total increase, 2018 – increase \$2.58 to \$33.68  
4 or 8.3 percent total increase, 2019 – increase \$2.81 to \$33.91 or 9.0 percent total  
5 increase, 2020 – increase \$3.05 to \$34.16 or 9.8 percent total increase, and, finally, by  
6 2021 – increase \$3.07 to \$34.18 or 9.9 percent total increase.<sup>128</sup>

7 Willow Valley – The rates proposed in the Agreement are phased-in over three years  
8 due to the fact that there are no ICFA's associated with Willow Valley. A 5/8 inch or  
9 3/4 inch customer with a median usage of 2,500 gallons currently has a bill of  
10 \$24.40.<sup>129</sup> With the rates being proposed in this case, this customer's bill would  
11 remain the same in 2014, during the first year of the three year phase-in.<sup>130</sup> In year  
12 two of the phase-in, that same customer's bill would increase \$6.17 to \$30.57 or a  
13 25.3 percent increase over present rates.<sup>131</sup> Finally, in year three of the phase-in, a  
14 median usage customer's bill would increase \$12.63 to \$37.03 or a 51.8 percent  
15 increase over present rates.<sup>132</sup>

16 **D. Other Provisions.**

17 **i. Low Income Tariff.**

18 The Agreement also proposes to continue Global Water Utilities low income tariff, and  
19 expand that tariff to WUNS.<sup>133</sup> Further, the Agreement proposes a CAGR D adjustor mechanism for  
20 WUGT.<sup>134</sup> The Company received a draft order from ADWR for approval of a Designation of  
21 Assured Water Supply (“DAWS”) for WUGT.<sup>135</sup>

22 **ii. Creation of a Code of Conduct.**

23 One of the more important provisions of the Agreement is that Global Water and Wastewater  
24 Utilities will work with Staff to adopt a Code of Conduct to apply to transactions that are between or  
25 involve the Global Applicants and any unregulated affiliates.<sup>136</sup> In addition, this Code of Conduct  
26 would assure confidential treatment of customer specific information including water and wastewater  
27 usage information.<sup>137</sup> At a minimum, this Code of Conduct will help define appropriate, and  
28 inappropriate, inter-affiliate activities with the Global Parent, and ensure that the Global Utilities are

<sup>128</sup> *Id.* at Attachment A, Santa Cruz Settlement H4.

<sup>129</sup> Settlement Agreement, Ex. A-17, Attachment A, Willow Valley Settlement H4.

<sup>130</sup> *Id.* at Attachment A, Willow Valley Settlement H4.

<sup>131</sup> *Id.* at Attachment A, Willow Valley Settlement H4.

<sup>132</sup> *Id.* at Attachment A, Willow Valley Settlement H4.

<sup>133</sup> *Id.* at 11.

<sup>134</sup> *Id.*

<sup>135</sup> Fleming Direct, Ex. A-10 at 16.

<sup>136</sup> Settlement Agreement, Ex. A-17 at 12.

<sup>137</sup> *Id.*

1 independent, stand-alone entities separate and apart from Global Parent and its other unregulated  
2 affiliates and that all transactions between these entities are on an arms-length basis.<sup>138</sup>

3 **IV. SNR AND NWP ARE THE ONLY PARTIES THAT OPPOSED THE SETTLEMENT**  
4 **AGREEMENT.**

5 Although both SNR and NWP did not sign the Agreement and oppose the settlement, both  
6 parties, to varying degrees, acknowledge that the Agreement addresses some of their concerns and  
7 provides them with protections they would not otherwise have but for the settlement. Additionally, it  
8 is important to remember that the ICFAs are voluntary agreements. There was not and is not any  
9 Commission requirement that developers must enter into ICFAs with Global.

10 **i. NWP.**

11 NWP is the developer of a 1,280 acre master planned community known as Copperleaf<sup>139</sup>  
12 which is located within the certificate of convenience and necessity of WUGT.<sup>140</sup> Mr. Jellies, a  
13 consultant hired by NWP, has worked with NWP since Copperleaf was brought to NWP as a  
14 potential investment.<sup>141</sup> NWP entered into an ICFA with Global in July 11, 2006.<sup>142</sup>

15 Mr. Jellies, in his prefiled testimony in opposition to the Agreement, testified on behalf of  
16 NWP that, because the Agreement does not resolve all of the important issues surrounding ICFAs  
17 generally or NWP's ICFA specifically, NWP cannot support the Agreement.<sup>143</sup> Specifically, Mr.  
18 Jellies asserts that the following issues are not resolved by the Agreement: (1) the Consumer Price  
19 Index ("CPI") adjustment factor contained in the ICFAs which applies and escalates developer  
20 payments made under the ICFAs; (2) the lack of protection of monies paid under ICFAs which  
21 exceed the amounts allocated to HUFs to ensure that those monies also flow to the utility which has  
22 the obligation to construct utility infrastructure for the developer; (3) the proposed 70%-30% split in  
23 future payments to Global Parent under the ICFA results in an underpayment of HUFs to WUGT and  
24 HUC; (4) the large percentage rate increase for the customers of WUGT without a sufficient phase-  
25 in; and (5) the unwillingness of Global Parent to modify the ICFA in a manner which protects it

26 <sup>138</sup> *Id.*

27 <sup>139</sup> Jellies Direct Test., Ex. NWP-3 at 4.

28 <sup>140</sup> *Id.*

<sup>141</sup> Tr. Vol. II at 288.

<sup>142</sup> Ex. NWP-1 ICFA.

<sup>143</sup> Jellies In Opposition to Settlement, Ex. NWP-4 at 4-5.

1 regulated subsidiaries and the public in the event of a Global Parent default or bankruptcy affecting  
2 the current ICFA.<sup>144</sup>

3 In prefiled testimony, NWP asserted that the Commission could address each of these in the  
4 following way: (1) the Commission could order Global to amend its ICFA to eliminate the CPI  
5 provision,<sup>145</sup> (2) the Commission should monitor Global Parent to ensure monies received are used  
6 for their intended purpose, including requiring Global Parent to segregate funds received above and  
7 beyond HUF amounts, and requiring amendment to the ICFA to make clear that monies to be used by  
8 WUGT and HUC to provide utility plant and transmission infrastructure belong to those utilities.<sup>146</sup>  
9 Although NWP does not propose any solution to its third concern, section 6.4.4 of the Agreement  
10 makes it clear that “Global Parent shall be responsible for ensuring that the entire HUF is paid no  
11 later than the time the ICFA payment is received for: (1) final plat, (2) the start work date, or (3) the  
12 date required by the HUF tariffs, whichever is earliest.”<sup>147</sup> NWP’s concern is therefore unfounded.

13 NWP also makes a twofold argument regarding the rate increase that is being proposed in the  
14 Agreement for WUGT. In particular, NWP recommends that the Commission deny any rate increase  
15 attributable to the reversal of the Commission-ordered imputation of ICFA funds as CIAC in the last  
16 rate case.<sup>148</sup> However, the Agreement proposes that the rates for WUGT continue to be set on a 10  
17 percent operating margin.<sup>149</sup> Therefore, the de-imputation of the ICFAs from WUGT’s active rate  
18 base has no effect on the rates in this case. Further, the Agreement indicates that in subsequent cases  
19 during the eight year phase-in the rates for WUGT will be reviewed from both a rate of return and 10  
20 percent operating margin perspective, and be set on whichever method produces the lowest rates.<sup>150</sup>  
21 NWP also asserts that the rates for WUGT should be phased-in over eight years, as is being proposed  
22 for Palo Verde.<sup>151</sup> Interestingly, WUGT is, in essence, being treated in the same manner as Palo  
23 Verde. The expenses for both systems are being phased-in over three years, and the reversal of the

24  
25 \_\_\_\_\_  
<sup>144</sup> *Id.* at 5.

26 <sup>145</sup> Jellies Settlement Testimony, Ex. NWP-4 at 7. at 7.

<sup>146</sup> *Id.* at 7-8.

27 <sup>147</sup> Settlement Agreement, Ex. A-17 at 10.

<sup>148</sup> Alexander Igwe Direct Test., at 5, July 8, 2013 (not admitted at hearing).

<sup>149</sup> Settlement Agreement, Ex. A-17 at 8.

28 <sup>150</sup> *Id.*

<sup>151</sup> Jellies Settlement Testimony, Ex. NWP-4 at 9.

1 ICFA rate base treatment from the last rate case is being phased-in over 8 years.<sup>152</sup> The only  
2 difference being, as mentioned above, the rates for WUGT are being set using an operating margin.  
3 If the rates were set using a rate of return, they would be three times higher than what is being  
4 proposed in the Agreement.<sup>153</sup>

5 During the hearing, NWP did narrow its issues to eliminating the CPI to the HUF portion of  
6 the ICFA payment, and amending the ICFA to allow payments directly to the utility.<sup>154</sup>

7 **B. SNR.**

8 SNR owns approximately 2,700 acres of entitled land in Maricopa County known as Silver  
9 Water Ranch and Silver Springs Ranch.<sup>155</sup> SNR entered into an ICFA with Global Water Resources  
10 LLC, the predecessor to Global Parent, on July 10, 2006.<sup>156</sup>

11 SNR indicated in its prefiled testimony that it wants: (1) the Commission to assert jurisdiction  
12 over Global Parent and the ICFAs in order to protect ratepayers and others that the infrastructure will  
13 serve; (2) ensure that the existence of the ICFA, in conjunction with the newly developed HUF in this  
14 case, will not put ICFA developers at a competitive disadvantage; (3) require Global Parent to modify  
15 the ICFAs to incorporate the provisions of the HUF in order to resolve inconsistencies between the  
16 two; and (4) review and regulate the financial condition of Global Parent so that it will be capable of  
17 fulfilling and actually fulfill all of its obligations under all ICFAs.<sup>157</sup>

18 During the hearing, Mr. O'Reilly, appearing on behalf of SNR, testified, in response to  
19 questions from Staff, that a number of the provisions contained in the Agreement address a number of  
20 SNR's concerns. In particular, SNR agreed that section 6.1.2 of the Agreement is a "great next step  
21 forward" and is "very helpful."<sup>158</sup> This section reads as follows:

22 Staff and RUCO reserve the right to monitor Global's compliance with this  
23 Settlement Agreement and review all ICFA related transactions in future rate  
24 applications that Global files, and take appropriate steps, if necessary, to ensure the  
continued resolution of the issues regarding ICFAs as set forth in this Agreement.<sup>159</sup>

25 <sup>152</sup> Settlement Agreement, Ex. A-17, Attachment A.

26 <sup>153</sup> Rowell Rebuttal, Ex. A-27 at 2.

27 <sup>154</sup> Tr. Vol. III at 377.

28 <sup>155</sup> O'Reilly Direct in Opposition, Ex. SNR-1 at 7.

<sup>156</sup> *Id.*, Ex. SNR-1 at Exhibit 2.

<sup>157</sup> *Id.*, Ex. SNR-1 at 4.

<sup>158</sup> Tr. Vol. II at 264.

<sup>159</sup> Settlement Agreement, Ex. A-17 at 6.

1 Similarly, SNR indicated that section 6.2.2 of the Agreement is a “step in the right direction”  
2 and is “helpful.”<sup>160</sup> This section reads in part as follows:

3 The Global Water and Wastewater Utilities, Hassayampa, Picacho Water, and  
4 Picacho Utilities will establish hook-up fees as set forth in Section VII.<sup>161</sup>

5 Further, Mr. O’Reilly admitted during the hearing that section 6.2.3 is likewise a “step in the  
6 right direction” and “is full and complete in terms of dealing with the ongoing assurances and  
7 regulation.”<sup>162</sup> This section of the Agreement reads as follows:

8 The Global Water and Wastewater Utilities, Hassayampa, Picacho Water, and  
9 Picacho Utilities will continue to use main extension agreements in accordance with  
10 Commission rules. Any associated funds or infrastructure (or land associated with  
11 the infrastructure which is conveyed to Global) used to provide water or wastewater  
12 service will be segregated to or owned by the Global Water and Wastewater Utilities,  
13 Hassayampa, Picacho Water or Picacho Utilities.<sup>163</sup>

14 Regarding future fees received under existing ICFAs, SNR agrees that section 6.4.1 resolves  
15 some of the concerns they have raised if the fees paid are sequestered so that any fees paid after  
16 December 31, 2013 are fully protected.<sup>164</sup> Under the settlement, seventy percent of the ICFA fees  
17 paid will be sequestered at the utility level. This section reads as follows:

18 ICFA fees received after December 31, 2013, will be handled as follows: a portion of  
19 funds received by Global Parent will be paid to the associated utility as a hook-up fee  
20 (“HUF”) to be established in accordance with this Agreement, and the remaining  
21 portion of the funds will be available to Global Parent for use pursuant to the  
22 provisions of the applicable ICFA.<sup>165</sup>

23 Similarly, SNR agrees that section 6.4.2 of the Agreement resolves some of their concerns.<sup>166</sup>  
24 This section indicates that Global Parent will accept separate checks for the ICFA fees that will allow  
25 the developer to make checks payable to the applicable water and wastewater utility in the amount of  
26 the HUF.<sup>167</sup> Global agreed during the hearing to enter into limited amendments to the ICFAs that  
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160 Tr. Vol. II at 264.

161 Settlement Agreement, Ex. A-17 at 7.

162 Tr. Vol. II at 265.

163 Settlement Agreement, Ex. A-17 at 7.

164 Tr. Vol. II at 265.

165 Settlement Agreement, Ex. A-17 at 9.

166 Tr. Vol. II at 266.

167 Settlement Agreement, Ex. A-17 at 9.

1 would allow the developers to pay the HUF portion of the ICFA fees directly to the applicable  
2 utility.<sup>168</sup>

3 SNR also agrees that section 6.4.4 of the Agreement satisfies seventy percent of their  
4 concerns by ensuring that a portion of the fees paid will go towards infrastructure development.<sup>169</sup>

5 The Agreement also addresses SNR's concern regarding proper use of any remaining funds  
6 by Global Parent. Specifically, SNR agrees that section 6.4.3 of the Agreement does address some of  
7 its concerns if "it is properly handled by Global and regulated to assure compliance."<sup>170</sup> This section  
8 indicates that "The Global Parent portion (ICFA Fee minus HUFs) is to be used only in accordance  
9 with the terms of the applicable ICFA."<sup>171</sup>

10 Finally, SNR agrees that sections 7.3 and 8.7 are "helpful", and that overall the settlement is  
11 designed to strengthen the financial condition of Global Utilities, which is a primary concern of SNR,  
12 and that it is a good step in the right direction.<sup>172</sup>

13 Staff agrees with SNR that resolution of the ICFA issues is of the utmost importance and that  
14 the status quo treatment of them absent the Agreement blurs the lines between the unregulated Global  
15 Parent and the regulated Global Utilities.<sup>173</sup> However, Staff believes that the Agreement "un-blurs"  
16 those lines and creates a solid and defined demarcation between Global Parent and the Global  
17 Utilities.<sup>174</sup> Additionally, SNR and NWP are asking that the Commission somehow amend the  
18 agreements that they voluntarily entered into with Global Parent to eliminate terms of those  
19 agreements. Specifically, SNR and NWP want to eliminate the CPI adjustor from the ICFAs. Their  
20 assertion is that the HUF that is established in the Agreement does not have a CPI adjustor and it is  
21 therefore unfair for the payments they make to Global Parent to be adjusted for inflation.<sup>175</sup>

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<sup>168</sup> Tr. Vol. III at 468.

<sup>169</sup> Tr. Vol. II at 267.

<sup>170</sup> Tr. Vol. II at 268.

<sup>171</sup> Settlement Agreement, Ex. A-17 at 10.

<sup>172</sup> Tr. Vol. II at 271.

<sup>173</sup> Armstrong Direct, Ex. S-2 at 4.

<sup>174</sup> Tr. Vol. IV at 729-730.

<sup>175</sup> O'Reilly, Ex. SNR-1 at 15, Jellies Settlement Testimony, Ex. NWP-4 at 6.

1 SNR witness, Mr. O'Reilly, testified that he is requesting that the Commission order GWR to  
2 modify the ICFAs to incorporate the provisions in the Agreement related to the establishment of HUF  
3 to resolve inconsistencies between the ICFA and the HUF.<sup>176</sup>

4 NWP witness, Mr. Jellies, testified that he is requesting that the Commission modify the  
5 ICFA between Global and NWP as it pertains to the CPI portion that is associated with the HUF and  
6 a segregation of monies paid to Global be used for infrastructure.<sup>177</sup>

7 The Commission cannot change or modify a contract that was voluntarily entered into  
8 between two private parties. *General Cable Corp. v. Citizens Utilities Co.*, 27 Ariz.App. 381, 555  
9 P.2d 350 (1976). Similarly, in *Application of Trico Elec. Co-op.*, 92 Ariz. 373, 387, 377 P.2d 309  
10 (1962) the Supreme Court discussed the Commission's constitutional power to prescribe the forms of  
11 contracts to be used by public service corporations under *Ariz. Const. Art. 15 § 3* and held that the  
12 Commission can determine the outline and designate the arrangement of topics to be incorporated  
13 therein but does not have authority to prescribe the content that are the specific contractual provisions  
14 to be agreed upon.

15 In addition to arguing the Agreement does not go far enough to protect all of the payments  
16 they make to Global Parent to ensure they will receive service when the times comes, SNR and NWP  
17 also argue that the Agreement re-characterizes the ICFAs and creates a disparate playing field  
18 between those developers with ICFAs and those without.<sup>178</sup> Staff believes that SNR and NWP  
19 entered into the ICFAs of their own free will and that, as a consequence, such agreements included a  
20 CPI adjustment factor.<sup>179</sup> Further, it is Staff's position that the terms of the Agreement mitigate any  
21 perceived disparity by allowing seventy percent of the ICFA fees to satisfy the HUFs that are  
22 established in the Agreement, and that the alternative would be to simply establish a HUF that all  
23 developers would have to pay regardless of whether they entered into an ICFA.<sup>180</sup> The other  
24 important factor to keep in mind is that SNR and NWP are receiving more pursuant to the ICFA than  
25 they would with just a HUF. NWP does not dispute this point. In fact, NWP agrees that, regardless

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27 <sup>176</sup> Tr. Vol. II at 229-230.

<sup>177</sup> Tr. Vol. III at 377-379.

<sup>178</sup> Tr. Vol. II at 305, O'Reilly, Ex. SNR-1 at 15.

<sup>179</sup> Tr. Vol. IV at 729.

<sup>180</sup> *Id.*

1 of the Agreement, both Global Parent and NWP still must fulfill all of the obligations pursuant to the  
2 ICFA.<sup>181</sup> The Company agrees that the Agreement proposes a resolution of the ICFA's for rate  
3 making purposes.<sup>182</sup>

4 Interestingly, both SNR and NWP argue in their prefiled testimony that they had no choice but to  
5 enter into the ICFA's with Global Parent.<sup>183</sup> As Global indicated, they could have worked with the  
6 prior owners of West Maricopa Combine, Inc., they could have worked with Balterra Sewer Corp., or  
7 they could have formed their own utility company. Although SNR was silent on these issues, NWP  
8 acknowledged they had options and ultimately chose to work with Global.<sup>184</sup> Further, Mr. Jellies  
9 indicated he has familiarity with the traditional tools of receiving service from a water utility that is  
10 regulated by the Commission. Also, Mr. Jellies was the project manager for SNR.<sup>185</sup> Ultimately, no  
11 homes have been built on either SNR's or NWP's property and neither SNR nor NWP know  
12 specifically when the first or last home will be built.<sup>186</sup>

13 **V. THE COMPANY AND STAFF AGREE THAT A SIB IS WARRANTED FOR THE**  
14 **WILLOW VALLEY SYSTEM.**

15 **A. The Company has made Significant Improvements to Willow Valley to Date.**

16 The SIB is the only issue in this case that was not part of the Agreement that all of the parties  
17 entered into except NWP, SNR, and WVCA. Although the Company initially sought a Distribution  
18 System Improvement Charge ("DSIC") and/or Collection System Improvement Charge ("CSIC") for  
19 all of the Global Applicants,<sup>187</sup> the Company later modified its request to a SIB, and only for Willow  
20 Valley.<sup>188</sup> Willow Valley serves approximately 1,500 customers in Mohave County.<sup>189</sup> It is located  
21 along the Colorado River north of Lake Havasu City and south of Bullhead City.<sup>190</sup> This system is  
22 part of the West Maricopa Combine that the Company acquired in 2006.<sup>191</sup> The service area of  
23 Willow Valley is comprised of the Cimmaron Water Systems and the King Street and Commercial

24 <sup>181</sup> Tr. Vol. III at 371.

<sup>182</sup> Tr. Vol. I at 67.

25 <sup>183</sup> O'Reilly Settlement Test., Ex. SNR-1 at 7, Jellies Direct Test., Ex. NWP-3 at 6.

<sup>184</sup> Tr. Vol. II at 294-300.

26 <sup>185</sup> Tr. Vol. II at 258.

<sup>186</sup> Tr. Vol. II at 255, Tr. Vol. III at 359.

27 <sup>187</sup> Walker Direct, Ex. A-13 at 20.

<sup>188</sup> Paul Walker Settlement Test., Ex. A-30 at 10.

28 <sup>189</sup> Fleming Settlement Test., Ex. A-19 at 7.

<sup>190</sup> *Id.*

<sup>191</sup> *Id.*

1 Street Water System.<sup>192</sup> The Company asserts that Willow Valley was in a poor and dilapidated state  
2 when the Company purchased it.<sup>193</sup> Since purchasing this system, the Company has undertaken  
3 significant improvements to address potential health and safety issues, and aesthetic issues with the  
4 water. Specifically, in 2007 and 2008, the Company completed the following projects:

5 Installed new chlorine injection systems;

6 Installed auto-dialer alarm systems to help prevent service outages;

7 Identified all existing water lines and performed hydraulic modeling to assist in  
8 planning improvements to maximize benefits;

9 Installed automatic flushing devices and operated an active flushing program to  
reduce the build-up of iron and manganese;

10 Completed the Unit 17 Water Distribution Center ("WDC") Improvement Project to  
11 address water clarity and reliability of service;

12 Completed the King Street WDC Improvement Project;

13 Completed the Cimmaron WDC Improvement Project to address water clarity and  
service reliability for the Cimmaron Development; and

14 Installed new control valves to improve ability to redirect water, isolate line breaks,  
15 and reduce the number of customers affected by outages.<sup>194</sup>

16 In total, the Company has invested approximately \$3.2 million since purchasing the West  
17 Maricopa Combine.<sup>195</sup> However, even with these investments, the Company asserts that, due to the  
18 condition of the remainder of the system, Willow Valley will need to replace most of the remaining  
19 pipeline system including water mains and water line loops, and install new valves where needed to  
20 eliminate frequent line failures and improve water quality and service reliability.<sup>196</sup>

21 **B. The Company Has Produced Sufficient Evidence to Justify a SIB for Willow**  
22 **Valley.**

23 During the hearing the Company produced samples of the water from the system and a sample  
24 of the pipe from the distribution system.<sup>197</sup> Both of these exhibits corroborate the Company's claims  
25 regarding the continued aesthetic problems with the water, and the condition of the pipe in the

26 <sup>192</sup> Revised Willow Valley Water Co. SIB Engineering Report, Ex. A-42 at 2.

27 <sup>193</sup> *Id.* at 50.

<sup>194</sup> Fleming Settlement Test., Ex. A-19 at 8.

<sup>195</sup> Tr. Vol. V at 805.

28 <sup>196</sup> Fleming Settlement Test., Ex. A-19 at 9.

<sup>197</sup> Photo of Pipe, Ex. A-40, Photo of Water Samples, Ex. A-41.

1 Willow Valley system. The Company also prepared a Revised Willow Valley Water Co. SIB  
2 Engineering Report that includes detailed project and cost information related to the Company's  
3 pipeline replacement program.<sup>198</sup> This report also sets forth, in detail, the type of material the pipes  
4 are comprised of as well as, the age, size, and condition of the pipes. In addition, the report describes  
5 known systematic issues with the distribution system.<sup>199</sup> The King Street and Commercial Street  
6 systems waterlines vary from 3" to 8" in diameter and include pipe materials of varying types of iron  
7 or black steel, certain types of plastic or PVC, and asbestos cement. The majority of the system is  
8 comprised of pipes more than 40 years old, with 90 percent of the valves being inoperable.<sup>200</sup> The  
9 distribution waterlines for the Cimmaron water system vary from 6" to 10" in diameter and are all  
10 PVC. Inspections have concluded that the infrastructure is fragile, severely corroded, and  
11 substandard in specifications, and that repairing a line when it breaks is very difficult due to the  
12 fragile state of the existing infrastructure.<sup>201</sup>

13 The Company's report also identifies four major systematic issues with the Willow Valley  
14 system. Most notable, the potable water distribution systems do not currently provide proper looping  
15 capabilities, which allows for an alternative method to supply customers water in the event of a line  
16 break. Also, looping would address water quality and aesthetic issues.<sup>202</sup> Second, the water  
17 distribution lines for the residential properties in the King Street Water System are installed in the  
18 backyards of the property owners.<sup>203</sup> This presents accessibility issues, which often result in greater  
19 costs and time required to complete repairs.<sup>204</sup> Further, this presents a potential public health  
20 situation because the line runs through the septic fields of the residential properties.<sup>205</sup> Third, as  
21 noted above, the majority of the valves in Willow Valley are inoperable which leaves large segments  
22 of the system exposed in the event of a line break or other service shutdown.<sup>206</sup> Finally, the system  
23 lacks fire hydrants, and the fire hydrants the system does have are outdated and poorly installed.<sup>207</sup>

24 \_\_\_\_\_  
198 Fleming Settlement Test., Ex. A-19 at 9, Willow Valley Engineering Report, Ex. A-42.

199 Revised Willow Valley Water Co. SIB Engineering Report, Ex. A-42 at 5.

200 *Id.*

201 *Id.*

202 *Id.*

203 *Id.* at 11.

204 *Id.*

205 *Id.*

206 *Id.* at 5.

207 *Id.* at 6.

1 In total, Willow Valley has experienced a total of 21 line breaks with the Unit 17 water  
2 distribution system since 2010.<sup>208</sup> In addition, both the King Street and Commercial Street Systems  
3 and the Lake Cimmaron System have experienced a water loss ranging from a low of 14 percent to a  
4 high of almost 24 percent.<sup>209</sup>

5 The Company states that the main goal of the projects it seeks to include in the SIB is to  
6 replace the aging infrastructure within the King Street system.<sup>210</sup> In total, the Company is seeking to  
7 include the following five major replacement projects in the SIB for the Willow Valley system:

8 Year 1 – Gordon Drive Line Replacement – The Company chose this project based  
9 on four critical criteria. First, the line runs through the backyards of residential  
10 homes, which complicates accessibility for maintenance of equipment and emergency  
11 repair services.<sup>211</sup> Second, sections of the pipe are made of asbestos-cement, which is  
12 being phased out due to availability of parts and health concerns.<sup>212</sup> Third, this line  
has experienced an increased number of line breaks, which ultimately has increased  
service disruptions.<sup>213</sup> Finally, this line is in the vicinity of septic systems and could  
be a health concern.<sup>214</sup> The Company estimates that the cost of this line replacement  
is \$211,491.<sup>215</sup>

13 Year 2 – Clearwater Drive Replacement – The Company identified this project based  
14 on three critical criteria. First, this line also currently runs through the backyards of  
15 residential homes, which complicates accessibility for maintenance of equipment and  
16 emergency repair services.<sup>216</sup> Second, sections of this pipe are also made of asbestos-  
17 cement, which is being phased out due to the lack of availability of parts and safety  
18 concerns.<sup>217</sup> Third, this line has experienced an increased number of line breaks.<sup>218</sup>  
19 The Company estimates that the cost for this line replacement is approximately  
20 \$171,022.<sup>219</sup>

21 Year 3 – A Street Line Replacement – The Company identified this project based on  
22 three critical criteria. First, the line also runs through the backyards of residential  
23 homes, which also complicates accessibility for maintenance of the equipment and  
24 emergency repair services.<sup>220</sup> Second, this line has been subject to three line breaks  
25 over the past two years.<sup>221</sup> The Company estimates that the cost of replacing this line  
26 is \$145,040.<sup>222</sup>

23 <sup>208</sup> Revised Willow Valley Water Co. SIB Engineering Report, Ex. A-42 at 6.

24 <sup>209</sup> *Id.* at 9.

25 <sup>210</sup> Revised Willow Valley Water Co. SIB Engineering Report, Ex. A-42 at 10.

26 <sup>211</sup> *Id.*

27 <sup>212</sup> *Id.*

28 <sup>213</sup> *Id.*

<sup>214</sup> *Id.*

<sup>215</sup> Liu Supp. Test., Ex. S-6 at 2.

<sup>216</sup> Revised Willow Valley Water Co. SIB Engineering Report, Ex., A-42 at 13.

<sup>217</sup> *Id.*

<sup>218</sup> *Id.*

<sup>219</sup> Liu Supp. Test., Ex. Ex. S-6 at 2.

<sup>220</sup> Revised Willow Valley Water Co. SIB Engineering Report, Ex. A-42 at 15

<sup>221</sup> *Id.*

<sup>222</sup> *Id.*

1            Year 4 – Wells Street Line Replacement – The Company identified this project for  
2 inclusion in the SIB based on two critical criteria. First, this line also runs through  
3 the backyards of residential homes, which complicates accessibility for maintenance  
4 of equipment and emergency repair services.<sup>223</sup> Second, this line has been subject to  
5 three line breaks over the past three years.<sup>224</sup> The company estimates that the cost for  
6 replacement of this line is \$133,701.<sup>225</sup>

7            Year 5 – Kingsway/Lark Lane/Border Lane Line Replacement – The Company  
8 identified this project for inclusion in the SIB based on three critical criteria. First,  
9 this line also runs through the backyards of residential homes, which complicates  
10 accessibility for maintenance of the equipment and emergency repair services.<sup>226</sup>  
11 Second, sections of this line are made from a combination of asbestos-cement and  
12 PVC, which is being phased out due the lack of availability of repair parts and safety  
13 concerns.<sup>227</sup> Third, this line has been subject to one line break over the past three  
14 years.<sup>228</sup> The Company estimates that it will cost \$214,979.<sup>229</sup>

15            Staff reviewed the Company’s Revised Willow Valley Water Co. SIB Engineering Report and  
16 the proposed 5-year infrastructure replacement plan at a cost of \$878,233 and found the proposal to  
17 be both reasonable and appropriate.<sup>230</sup>

18            **C.     The SIB Mechanism.**

19            The Company is seeking a SIB mechanism for Willow Valley as set forth in Decision No.  
20 73938<sup>231</sup> and is requesting that the SIB be governed by all of the conditions and requirements that are  
21 set forth in that Decision, including the attached settlement agreement.<sup>232</sup> The Company has also  
22 agreed to codify the Willow Valley SIB, if authorized, in a Plan of Administration (“POA”) that  
23 would tailor the SIB for Willow Valley to the specifics of this case.<sup>233</sup> As set forth in Decision No.  
24 73938, some of the key provisions of the SIB mechanism are as follows:

- 25            •     Approval of SIB-Eligible Projects – All SIB-eligible projects must be  
26 reviewed by Staff and approved by the Commission prior to being included in  
27 the SIB surcharge. All of the projects must be completed and placed into  
28 service prior to being included in the SIB surcharge. Willow Valley must file  
a report with the Commission every six months summarizing the status of all  
SIB-eligible projects.<sup>234</sup>

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24            <sup>223</sup> Revised Willow Valley Water Co. SIB Engineering Report, Ex. A-42 at 17.  
25            <sup>224</sup> *Id.*  
26            <sup>225</sup> Liu Supp. Test., Ex. S-6 at 2.  
27            <sup>226</sup> Revised Willow Valley Water Co. SIB Engineering Report, Ex. A-42 at 19.  
28            <sup>227</sup> *Id.*  
              <sup>228</sup> *Id.*  
              <sup>229</sup> Liu Supp. Test., Ex. S-6 at 2.  
              <sup>230</sup> *Id.*  
              <sup>231</sup> Walker Settlement Test., Ex. A-30 at 10.  
              <sup>232</sup> Tr. Vol. V at 865.  
              <sup>233</sup> Tr. Vol. V at 866.  
              <sup>234</sup> Decision No. 73938, Ex. A-45 at 19.

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- Costs Eligible for SIB Recovery – Cost recovery under the SIB mechanism is allowed for the pre-tax return on investment and depreciation expense associated with those projects, net of associated plant retirements. The rate of return, depreciation rates, gross revenue conversion factor and tax multiplier are to be the same as established in this case.<sup>235</sup>
- Efficiency Credit – The SIB surcharge will include an efficiency credit equal to five percent of the SIB revenue requirement.<sup>236</sup>
- Surcharge Cap – The amount that can be collected annually by each SIB surcharge filing is limited to 5 percent of the revenue requirement established.<sup>237</sup>
- Timing of SIB Surcharge Filing – The Company: may file up to five SIB surcharge requests between rate case decisions; may make no more than one SIB surcharge filing every 12 months; may not make an initial SIB surcharge filing prior to 12 months following the effective date of a decision in this case; must make an annual SIB surcharge filing to true-up its surcharge collections; and, must file a new rate case application no later than June 30, 2018 with a test year ending no later than December 31, 2017, at which time any SIB surcharge then in effect would be reviewed for inclusion in base rates in that proceeding and the surcharge would be reset to zero.<sup>238</sup>
- SIB Rate Design – The SIB surcharge will be a fixed monthly charge on customers’ bills, with the surcharge and efficiency credit listed as separate line items. The surcharge will increase proportionately based on customer meter size.<sup>239</sup>
- Commission Approval of SIB Surcharge – Each SIB surcharge must be approved by the Commission prior to implementation. Upon filing of the SIB surcharge application, Staff and RUCO would have 30 days to review the filing and dispute and/or file a request for the Commission to alter the surcharge or true-up surcharge/credit.<sup>240</sup>
- Public Notice – At least 30 days prior to a SIB surcharge becoming effective, the Company is required to provide public notice to customers in the form of a bill insert or customer letter. The notice must include: the individual surcharge amount by meter size; the individual efficiency credit by meter size; the individual true-up surcharge/credit by meter size; and, a summary of the project included in the current surcharge filing, including a description of each project and its cost.<sup>241</sup>

In addition, the SIB requires that the Company file the following information with each SIB adjustment: (1) the most current balance sheet at the time of the filing; (2) the most current income statement; (3) an earnings test schedule; (4) a rate review schedule (including the incremental and pro

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<sup>235</sup> Decision No. 73938, Ex. A-45 at 19.  
<sup>236</sup> *Id.* at 20.  
<sup>237</sup> *Id.* at 20.  
<sup>238</sup> *Id.* at 20.  
<sup>239</sup> *Id.* at 20.  
<sup>240</sup> *Id.* at 20.  
<sup>241</sup> *Id.* at 21.

1 forma effects of the proposed increase; (5) a revenue requirement calculation; (6) a surcharge  
2 calculation; (7) an adjusted rate base schedule; (8) a construction work in progress (“CWIP”) ledger  
3 (for each project showing accumulation of charges by month and paid vendor invoices); (9)  
4 calculation of the three factor formula; and, (10) a typical bill analysis under present and proposed  
5 rates.<sup>242</sup> The Company also should provide current bill determinants.

6 The SIB also requires that the Company perform an earnings test calculation for each initial  
7 filing and annual report filing to determine whether the actual rate of return reflected by the operating  
8 income for the affected system or division for the relevant 12-month period exceeded the most  
9 recently authorized fair value rate of return for the affected system or division, with the earnings test  
10 to be: based on the most recent available operating income, adjusted for any operating revenue and  
11 expense adjustments adopted in the most recent general rate case; and, based on the rate base adopted  
12 in the most recent general rate case, updated to recognized changes in plant, accumulated  
13 depreciation, CIAC, Advances in Aid of Construction (“AIAC”), and accumulated deferred income  
14 taxes through the most recent available financial statement (quarterly or longer). If the earning test  
15 calculation shows that the Company will not exceed its authorized rate of return with the SIB  
16 surcharge, the surcharge may go into effect once approved by the Commission. If the earnings test  
17 calculation shows that the Company will exceed its authorized rate of return with the implementation  
18 of any of the surcharge, the surcharge my not go into effect. However, if the earnings test calculation  
19 shows the Company will exceed its authorized rate of return with the implementation of the full  
20 surcharge, but a portion of the surcharge may be implemented without exceeding the authorized rate  
21 or return, then the surcharge may be authorized up to that amount once approved by the  
22 Commission.<sup>243</sup>

23 **D. SIB Revenues and Bill Impacts.**

24 Assuming that Willow Valley does not over earn during the pendency of the SIB, which  
25 would disallow any recovery through the SIB mechanism, the rate schedules show the amount of  
26 revenue the Company will recover on, and of, the money it invests in the SIB plant over the five year

27 <sup>242</sup> Decision No. 73938, Ex. A-45 at 50-51. It is the intent that all requirements from Decision No. 73938 apply in this  
28 case. However, some of the information ordered in this decision may need to be modified to fit the context of this case.  
Any such modifications will be addressed in the plan of administration that the parties prepare.

<sup>243</sup> *Id.*

1 period that the SIB will be in place. Specifically, in 2015, for the plant that the Company plans to  
2 replace in 2014 estimated to be \$211,491, the Company will recover an additional \$25,976 in revenue  
3 through the SIB. Likewise in 2016, the Company will collect \$20,437 in revenue for the \$171,022 of  
4 plant that it installed in 2015, for a total revenue increase of \$46,413 in 2016. By the conclusion of  
5 the five year period, the Company will collect total additional revenue through the SIB, after  
6 deduction of the efficiency credit, of \$316,603.<sup>244</sup>

7 The monthly surcharge amounts for 5/8 inch x 3/4 inch meter customers are as follows: 2015 -  
8 \$1.21; 2016 - \$2.17; 2017 - \$2.95; 2018 - \$3.65; and 2019 - \$4.80.

9 With the rates that are being proposed for Willow Valley in the Agreement, the SIB surcharge  
10 would have the following impact on a median use 5/8 inch or 3/4 inch meter customer:

11 In 2015, the typical bill would increase from \$24.40 to \$30.57, and the customer  
12 would pay an additional \$1.21 per month in the form of a SIB surcharge above the  
\$30.57.

13 In 2016 the typical bill would increase to \$37.03 and would remain at that amount  
14 through 2019 since the rate phase-in is complete. The monthly SIB surcharge  
increases as follow: 2016 - \$2.17; 2017 - \$2.95; 2018 - \$3.65; and 2019 - \$4.80.<sup>245</sup>

15 **E. The SIB Comports with the Arizona Constitution.**

16 The SIB that the Company is seeking for Willow Valley fulfills and is consistent with all of  
17 the requirements of the Arizona Constitution. However, RUCO will likely claim that the proposed  
18 SIB is inconsistent with the fair value provision of the Arizona Constitution. The SIB provides  
19 ample opportunity for the Commission to ascertain Global Applicants' fair value rate base and,  
20 thereby, comply with the requirements of the Arizona Constitution.

21 As discussed above, the Company is required to provide updated financial information  
22 (including a balance sheet, income statement, earnings test schedule, rate review schedule, revenue  
23 requirement calculation, surcharge calculation, adjusted rate base schedule, etc.) as part of the filing  
24 package every time it seeks Commission authorization to enact a SIB surcharge. This information  
25 will enable the Commission to update the fair value rate base finding and determine the impact of the  
26 revenues (with the addition of the proposed SIB surcharge) on the Company's fair value rate of

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28 <sup>244</sup> Late filed exhibit on October 4, 2013, Notice of Filing Rate Schedules including Systems Benefits Charge – This  
represent the total of amounts on line titled ADDITIONAL REV FOR SIB, LESS EFF. CREDIT.

<sup>245</sup> *Id.*

1 return. The SIB surcharge cannot go into effect without a Commission order and, ultimately, the  
2 Commission may terminate the SIB at any time.

3 RUCO cannot convincingly claim that the SIB is *per se* inconsistent with the Constitution's  
4 fair value requirements because the proposed SIB expressly requires the Company to provide updated  
5 rate base information. To argue that the proposed SIB will not comply with the Constitution implies  
6 that the Commission will ignore this information and not use it "to aid it in the proper discharge of its  
7 duties . . . ." See Ariz. Const. art XV, § 14. It is not reasonable to assume that the Commission will  
8 not act in accordance with the Constitution as to its future rate setting; instead, the opposite should be  
9 presumed.

10 RUCO may also argue, as it has in other cases where a SIB has been proposed before the  
11 Commission, that the Commission may not determine a Company's fair value rate base by relying on  
12 a recent fair value finding (from a recent rate case) as a starting point and then updating that finding  
13 with new information. However, the Commission has wide discretion to decide the method it uses to  
14 determine fair value. As our Supreme Court has recognized, "the commission in exercising its rate-  
15 making power of necessity has a range of legislative discretion . . . ." *Simms v. Round Valley Light &*  
16 *Power Co.*, 80 Ariz. 145, 154, 294 P.2d 378, 384 (1956). In addition, the Company will be providing  
17 updated information that will allow the Commission to make new fair value findings.

18 In the present case, the proposed SIB would provide a means for the Commission to update  
19 the Company's fair value rate base and thereby implement a series of step increases. This ratemaking  
20 mechanism is designed to allow the Company to undertake its substantial replacement program  
21 without having to resort to a repeated series of rate cases. See *Arizona Corp. Comm'n v. Ariz. Pub.*  
22 *Serv. Co.*, 113 Ariz. 368, 371, 555 P.2d 326, 329 (1976), (noting that a "constant series of rate  
23 hearings" does not serve the public interest). General rate cases can be time consuming and costly,  
24 both for the Company and for ratepayers, who pay for the costs of the rate case in rates.

25 In *Arizona Community Action Assoc. v. Ariz. Corp. Comm'n*, 123 Ariz. 228, 599 P.2d 184  
26 (1979), the court upheld step rate increases based on subsequent additions to the company's plant.  
27 Specifically, the company was granted a six percent rate increase in year 1; in years 2 and 3 the  
28 company was permitted to increase its rates by a maximum of five percent per year if certain

1 conditions were met. For the step 2 increase, the company was permitted to increase its rates by the  
2 lesser of five percent of gross operating revenues or a revenue deficiency,

3 calculated by first totaling (1) the amount of electric properties placed in service since  
4 the prior rate increase, (2) construction work in progress for the preceding calendar  
5 year for any plant for which construction work in progress had previously been  
included in rate base, and (3) construction work in progress during the preceding  
calendar year for plants scheduled to go into service within two years.

6 123 Ariz. at 229, 599 P.2d at 185 (emphasis added). The sum of these amounts was then to be  
7 multiplied by the rate of return on electric plant authorized by the Commission. The court upheld this  
8 portion of the Commission's order, stating,

9 The Commission stated in the decision under attack that it . . . would initiate  
10 innovative procedures in an attempt to deal promptly and equitably with increasingly  
11 complex regulatory matters. At the Step I hearing, the Commission fulfilled the  
constitutional requirements of art. 15, §§ 3, 14, which mandate a finding of the fair  
value of all property at the time of fixing a rate.

12 The court further indicated that it did not "find fault" with the Commission's efforts to avoid a  
13 "constant series of extended rate hearings . . ." 123 Ariz. at 231, 599 P.2d at 187. Finally, the court  
14 noted that the Commission's order in the rate case "resulted in a determination of fair value [,]" and  
15 that further adjustments between rate cases "were adequate to maintain a reasonable compliance with  
16 the constitutional requirements if used only for a limited period of time." *Id.* (emphasis added).

17 The proposed SIB has been developed in the context of a full rate case in which the  
18 Commission has determined the Company's fair value rate base and approved the specific plant  
19 projects to be included in the SIB. The SIB will be limited to projects that replace plant used to serve  
20 existing connections. The SIB further provides for the retirement (removal from rate base) of the  
21 plant that has been replaced. Therefore, the new plant will not generate a new revenue stream.

22 As noted earlier, the amount to be collected by each SIB surcharge is capped at five percent of  
23 the revenue requirement established in Decision No. 73736, Phase 1 of Docket No. W-01445A-11-  
24 0310. These amounts are subject to true-up, either in the annual SIB filings or in the Company's next  
25 full rate case. Finally, the Company will have to file a full rate case by June 30, 2018, with a test  
26 year ending December 31, 2017. These features serve to ensure that the resulting rates will be just  
27 and reasonable and that the SIB will be used only for a limited period of time.

28

1 In *Community Action* the step increase mechanism was ultimately set aside by the court.  
2 While this is ultimately true, it is important to note that the court did not find fault with the step  
3 increases *per se*; instead, it found that the step increase was triggered solely on a percentage of return  
4 on common equity, which fell largely within the Company's control. For this reason, it could not be  
5 the "sole criterion" for triggering the step increase. *Community*, 123 Ariz. at 231, 599 P.2d at 187.

6 The instant SIB, however, differs from the step increase mechanism in *Community Action* in  
7 that there isn't any "test" subject to control by the Company. In fact, there is no guarantee that the  
8 Commission will authorize each increase as it depends on whether it is determined that the Company  
9 is earning more than its authorized rate of return. Further, the Commission may suspend the SIB.

10 Moreover, each annual SIB surcharge requires Commission approval in order to take effect.  
11 The Company is required to provide information with each SIB filing that will allow the Commission  
12 to determine the impact of the new plant on the Company's fair value rate base and consider the  
13 resulting impact on the Company's rate of return. Arizona case law does not require more.

14 RUCO may argue that the SIB is an example of "single issue ratemaking" and that such an  
15 approach is prohibited by *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531, 578 P.2d 612 (App. 1978).  
16 That case, however, focuses upon the requirements of Article XV, section 14 of the Arizona  
17 Constitution, which pertain to determining fair value rate base:

18 "We . . . hold that the Commission was without authority to increase the rate without  
19 any consideration of the overall impact of that rate increase upon the return of . . . [the  
20 utility], and without, as specifically required by our law, a determination of . . . [the  
utility's] rate base."<sup>246</sup>

21 However, Article XV, section 14 is silent as to "single issue ratemaking." Wherever that term may  
22 have originated, it is not contained in the Arizona Constitution.

23 The *Scates* court was careful to make it clear that a full rate case is not required for every  
24 increase in rates.<sup>247</sup> The court noted that "[t]here may well be exceptional situations in which the  
25 Commission may authorize partial rate increases without requiring" a full rate case. Therefore, the  
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28 <sup>246</sup> *Scates*, 118 Ariz. at 537, 578 P.2d at 618.

<sup>247</sup> *Id.*

1 case does not preclude the Commission from updating previous findings based upon new  
2 information.<sup>248</sup>

3 In recognition of the *Scates* decision, the proposed SIB clearly requires the Company to  
4 submit such information. There is no reason to presume that the Commission will not appropriately  
5 consider this information when evaluating each SIB surcharge filing. Even if the Commission were  
6 to fail to do so, the time for a challenge is after the Commission has acted. It is inappropriate to  
7 assume that the Commission will fail in its future constitutional duties, especially when the proposed  
8 SIB mechanism contains all the required ratemaking elements.

9 **F. RUCO Has NOT Provided A Valid Justification For Rejecting the SIB In This**  
10 **Case.**

11 RUCO provides four major reasons for opposing the adoption of the SIB. First, RUCO  
12 argues that the SIB allows for the recovery of routine plant improvements outside of a rate case that  
13 would normally be recovered in a general rate case.<sup>249</sup> Initially, RUCO claimed that there was  
14 nothing extraordinary about the plant additions that the Company is seeking to address through the  
15 SIB, and that normal regulatory procedures allow cost recovery of these types of plant additions.<sup>250</sup>  
16 However, during the hearing, RUCO acknowledged that the sample of the infrastructure that the  
17 Company produced was not ordinary.<sup>251</sup>

18 Second, RUCO asserts that the SIB is one-sided and only works in the interest of the  
19 Company and its shareholders.<sup>252</sup> However, unlike the DSIC-like mechanisms RUCO uses for  
20 comparison purposes, the SIB incorporates an efficiency credit that reduces by five percent the  
21 amount that customers would otherwise pay for this plant if the Company simply sought to recover  
22 such costs in its next rate case. RUCO claims the efficiency credit is insignificant, but does not  
23 propose an alternative.

24 Third, RUCO contends that there is no federal or state mandates that require the recovery of  
25 routine plant investments through a surcharge.<sup>253</sup> RUCO appears to be claiming that there must be

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26 <sup>248</sup> *Scates*, 118 Ariz. 531, 578 P.2d 612 (App. 1978).

27 <sup>249</sup> Rigsby Direct, Ex. R-4 at 6.

<sup>250</sup> *Id.* at 7.

<sup>251</sup> Tr. Vol. V at 959.

28 <sup>252</sup> Rigsby Direct, Ex. R-4 at 6.

<sup>253</sup> *Id.* at 7.

1 some sort of a state or federal mandate before a SIB would be permitted.<sup>254</sup> Although RUCO did not  
2 cite to any authority to support that claim, it appears they are simply trying to distinguish the SIB  
3 from the Arsenic Cost Recovery Mechanism (“ACRM”), the latter of which they support. Contrary  
4 to RUCO’s assertion, there is no requirement of a federal or state mandate before the Commission  
5 can exercise its ratemaking authority to create the SIB or the ACRM.

6 Finally, RUCO indicates that the Company has not proven they would be unable to ensure  
7 safe and reliable water service or achieve cost recovery without the SIB.<sup>255</sup> It is RUCO’s position  
8 that the Company should replace aging infrastructure as part of the Company’s normal course of  
9 infrastructure improvements to ensure continued safety and reliability.<sup>256</sup> RUCO further claims that a  
10 surcharge is not necessary for the Company to meet this obligation, that the Company is not claiming  
11 the SIB is necessary for it to meet this obligation or that the Company has not alleged that it is  
12 financially unable to do so.<sup>257</sup> RUCO is correct that Company is not claiming it will not be able to  
13 meet its obligation to provide safe and reliable water service without the SIB.<sup>258</sup> Further, none of the  
14 parties dispute the condition of the plant that the Company is seeking to include in the SIB and that  
15 such plant needs to be replaced. The sole issue is the time of the replacement and, more specifically,  
16 when the Company would receive a return on the investments. RUCO argued that the Company  
17 would have sufficient funds to cover the cost of projects sought in the SIB through the depreciation  
18 expense and O&M expense that will be built into the current rates.<sup>259</sup> However, RUCO also  
19 acknowledges that they failed to account for other projects the Company will be undertaking during  
20 that same time period that would not be covered by the SIB.<sup>260</sup>

21 In addition to the four main reasons addressed above, RUCO also addresses its concerns with  
22 the efficiency credit, and the timing of the final SIB filing made by the Company. Regarding the first  
23 issue, RUCO asserts that the efficiency credit is very insignificant compared to the amount the  
24 Company will be collecting through the SIB surcharge.<sup>261</sup> In conjunction with this assertion, RUCO

25 \_\_\_\_\_  
26 <sup>254</sup> Rigsby Direct, Ex. R-4 at 9.

<sup>255</sup> *Id.* at 7.

<sup>256</sup> *Id.* at 10.

<sup>257</sup> *Id.*

<sup>258</sup> Tr. Vol. V at 810.

<sup>259</sup> Tr. Vol. V at 937.

<sup>260</sup> Tr. Vol. V at 958.

<sup>261</sup> Mease Responsive Test., Ex. R-8 at 9.

1 argues that with Global investing approximately \$876,233 over five years in old, outdated and  
2 leaking infrastructure there would be a saving in O&M expense in excess of the efficiency credit.<sup>262</sup>  
3 However, RUCO has not proposed an alternative dollar amount for the Commission's  
4 consideration<sup>263</sup> and, in this case in particular, has failed to acknowledge that certain O&M expenses  
5 have already been reduced to reflect what those expenses would be with a 10 percent water loss.  
6 Also, RUCO acknowledges that even with the replacement of old infrastructure there may not be a  
7 resultant reduction in O&M.<sup>264</sup> As part of its argument, RUCO seems to assert that a reason for not  
8 adopting a SIB is that the Company will have no incentive to control its costs with this type of  
9 mechanism in place. However, this argument erroneously assumes two things. First, that the  
10 Company would be willing to haphazardly increase its expenses in lieu of earning its authorized rate  
11 of return. Second, that Staff, RUCO and ultimately the Commission would fail to address this issue  
12 in the follow up rate case required with the SIB.

13 RUCO also claims there were only two days to review and address the Company's request for a  
14 SIB in this case.<sup>265</sup> RUCO's assertion is incorrect. Staff worked extensively with the Company from  
15 July through early September regarding the Company's request for a SIB.<sup>266</sup> Even RUCO  
16 acknowledges that they received an earlier draft of the engineering report prior to filing their  
17 testimony.<sup>267</sup> The fact that RUCO may or may not have participated in that process should not be a  
18 basis for denying a SIB in this case.

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26 <sup>262</sup> *Id.* at 9.  
27 <sup>263</sup> Tr. Vol. V at 949.  
<sup>264</sup> Tr. Vol. V at 946.  
28 <sup>265</sup> Mease Responsive Test., Ex. R-8 at 7.  
<sup>266</sup> Tr. Vol. V at 907.  
<sup>267</sup> Tr. Vol. V at 949, 968.

1 VI. CONCLUSION.

2 For the reasons discussed above, Staff recommends the Commission adopt the Agreement,  
3 authorize the SIB for Willow Valley, and reject the positions of NWP, SNR, WVCA, and RUCO, to  
4 the extent they conflict with Staff's recommendations.

5 RESPECTFULLY SUBMITTED this 18<sup>th</sup> day of October, 2013.

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12 The Original and thirteen (13) copies  
13 of the foregoing were filed this 18<sup>th</sup>  
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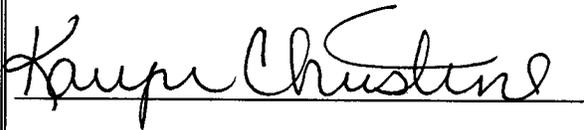
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