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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission  
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IN THE MATTER OF THE APPLICATION  
OF EPCOR WATER ARIZONA INC. FOR  
A CERTIFICATE OF CONVENIENCE  
AND NECESSITY TO PROVIDE  
WASTE WATER UTILITY SERVICE IN  
MARICOPA COUNTY, ARIZONA

DOCKET NO. WS-01303A-15-0018  
RESPONSE TO STAFF REPORT

Pursuant to the Procedural Order docketed May 7, 2015, EPCOR Water Arizona Inc. ("EWAZ" or "Company") offers the following responses to the Arizona Corporation Commission ("Commission") Staff Report docketed on June 26, 2015 (the "Report").

As an initial matter, EWAZ does not object to Staff recommendations numbered 1, 3, 4, 5, 7, 8, 13, 14, 15, and 16.<sup>1</sup> EWAZ's objections and clarifications to the remaining Staff recommendation are set out below.

**1. EWAZ Objects to Staff's Recommended Rates (No. 2).**

Staff's proposed rates are unreasonable on their face and will adversely impact the regional solution afforded by the proposed Loop 303 Wastewater Service Area. The

<sup>1</sup> EWAZ reserves the right to object to Staff recommendation number 4 and to request a hook-up fee to partially offset the millions of dollars it would be required to invest to construct the backbone infrastructure necessary to provide wastewater service to the Loop 303 area in the event that Staff's recommendations numbered 9 and 10, which disallow certain contributions and advances in aid of construction and require EWAZ to refund all amounts paid by the landowners requesting service pursuant to existing agreements, are adopted by the Commission.

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1 present Application represents a coordinated and cooperative effort by a diverse group of  
2 landowners and developers, along with the City of Glendale, the Maricopa Association of  
3 Governments (“MAG”), Maricopa County Environmental Services Department  
4 (“MCESD”) and EWAZ, to provide a regional wastewater solution for a large section of  
5 the west valley. Rather than having a series of smaller, package plants providing  
6 wastewater service to individual developments, which impose substantial regulatory,  
7 operational and permitting costs on utilities and consumers, the landowners in the Loop  
8 303 area recognized the long-term value of a very early stage regional approach and  
9 worked together with Global Water Resources (the original utility party to the agreements  
10 assumed by the Company and EWAZ’s predecessor in interest) to create a contractual  
11 arrangement that would allow construction of the common infrastructure necessary to  
12 support a regional approach in addition to the development specific infrastructure required  
13 to provide service. The landowners came together before specific development plans were  
14 in place and contractually committed themselves to the regional approach. The regional  
15 approach has been recognized by MCESD and the Arizona Corporation Commission  
16 (“Commission”) in a prior application filed by the Company as the preferred alternative for  
17 wastewater service in Maricopa County. See Decision No. 65757 (March 20, 2003) at 10  
18 (finding that “[t]he regional development of water and wastewater service proposed by  
19 Applicant and supported by the MCESD during this proceeding establishes that  
20 [Applicant’s] approach is reasonable and should be adopted”). However, that approach is  
21 only viable if the initial rates adopted by the Commission are conducive to the  
22 development of the Loop 303 area. Staff’s initial proposed rates are excessive and will  
23 stifle that development. See, e.g., Docket No. SW-01303A-09-0343 (opposition by  
24 ratepayers in Agua Fria wastewater district to rates lower than those proposed by Staff in  
25 this docket). If sufficient development does not occur, a regional wastewater treatment  
26 solution is not feasible.

1 EWAZ has proposed, in order to facilitate development and protect ratepayers, that  
2 the Loop 303 Wastewater Service Area break even at the end of the fifth year of  
3 operations, recovering all operating expenses of \$3,056,905.<sup>2</sup> Staff, however, recommends  
4 that EWAZ earn \$2,069,571 in income and recover \$4,336,190 in operating expenses,  
5 which requires revenues of \$6,395,151, at the end of the fifth year of operation of the  
6 proposed wastewater district. Staff arrived at its recommendation principally by increasing  
7 EWAZ's proposed rate base at year five by \$14,129,207 and adjusting revenues to  
8 generate a 6.4 percent rate of return.<sup>3</sup> See Report, Attachment 2, pp. 3-6. Staff's higher  
9 rate base is primarily attributable to the elimination of all Advances in Aid of Construction  
10 ("AIAC") and Contributions in Aid of Construction ("CIAC") attributable to the  
11 Wastewater Facilities Main Extension Agreements ("WFAs") entered into between the  
12 landowners requesting wastewater service and EWAZ's predecessor in interest. As  
13 discussed in section 3 below, Staff's proposed treatment of those funds is not consistent  
14 with Commission practice or Arizona law and should not be adopted.

15 EWAZ's proposed initial rates already exceed the rates charged by the Company in  
16 any of its other wastewater districts. Staff's recommended rates are double the rates  
17 proposed by the Company. Staff's proposed rate would result in an average monthly bill  
18 for residential wastewater service of \$170.83. Report, Attachment 2, p. 8. If adopted,  
19 development in the area will likely be curtailed and the proposed regional approach will  
20 not be feasible. The area would then be faced with finding acceptable solutions for  
21 wastewater service, which would most likely result in proposals to provide service to the  
22 area through multiple smaller, stand-alone package plants, which are typically opposed by  
23

24 <sup>2</sup> While the Company generally seeks a return in a new CC&N, the Company has proposed  
25 rates in this instance that break even in the fifth year of operations to allow development to  
26 occur in the area and enable the long-term regional solution. EWAZ anticipates filing an  
application seeking a reasonable return on equity following the fifth year of operations.

<sup>3</sup> Staff's uses its recommended rate of return from the Company's pending rate case in  
Docket No. WS-01303A-14-0010. That rate of return is disputed by EWAZ, and EWAZ  
objects to its use in this context.

1 MCESD and counter to the MAG 208 amendment for this area. This will certainly result  
2 in limited opportunities for development and for using reclaimed water in the area.  
3 Because Staff's recommended rates are unreasonable and will hamper development in the  
4 Loop 303 area, Staff's recommendation should not be adopted.<sup>4</sup>

5 **2. EWAZ Objects to Staff's Recommendation (No. 6) that EWAZ Infuse**  
6 **Additional Paid-In-Capital and Retained Earnings to Fund Construction of**  
7 **Backbone Infrastructure.**

8 EWAZ objects to Staff's recommendation No. 6 with respect to paid-in-capital,  
9 because Staff's recommendation ignores EWAZ's actual capital structure. Rather than  
10 utilizing the Company's overall capital structure in its analysis, Staff selectively treats the  
11 proposed new Loop 303 CC&N as a stand-alone company for purposes of its  
12 recommendation. In contravention of normal ratemaking practice, Staff breaks the  
13 Company's capital structure into short and long-term debt, common equity, AIAC and  
14 CIAC. Staff then includes \$14,792,974 in AIAC (related to development specific  
15 infrastructure) before performing its capital structure breakout.

16 Staff's recommendations with respect to the treatment of AIAC and CIAC might  
17 conceivably make sense for a small developer owned stand-alone system that has no  
18 operational history and inadequate financial backing. In that case, low equity and high  
19 AIAC or CIAC balances might result in a rate base that is too small to generate operating  
20 income sufficient to maintain the system and to attract capital in the future. Staff's  
21 recommendation lacks merit in the present case, however, as EWAZ has the ability to  
22 attract capital and to maintain its plant facilities as needed to provide safe and reliable

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23 <sup>4</sup> Staff's revenue calculations also appear erroneous. Using Staff's revised depreciation  
24 expense calculations and its proposed revisions to property taxes, the required revenue  
25 should be no more than \$3.347 million at break-even (revenues equal to expenses). To  
26 generate Staff's recommended return on the Staff recommended rate base would require  
additional revenues equaling \$2.059 million. Combined, Staff's total required revenue  
should be no more than \$5.406 million. Staff's rate design, however, generates \$6.395  
million in revenue, or an overstatement of at least \$0.989 million. If Staff's proposed rates  
are adopted, which EWAZ contests, Staff's recommended rates should be amended to  
correct this error.

1 service to customers. The rate making process provides for the recovery of historical  
2 operating expenses adjusted for known and measurable cost level changes, such as  
3 maintenance. Infrastructure replacements, which may require access to capital, should not  
4 be necessary for many years. As the Report acknowledges, EWAZ currently has adequate  
5 resources to provide the requested services. Report, Attachment 2, p. 7. Staff does not  
6 claim that will change if the requested CC&N is granted. Moreover, the impact of Staff's  
7 recommendations on the Company's capital structure for ratemaking purposes in the future  
8 is non-existent. Under both the Company's and Staff's proposals, the Company's capital  
9 structure for ratemaking purposes moving forward would consist of -0.15 percent short-  
10 term debt, 58.88 percent long-term debt and 41.27 percent common equity. Report,  
11 Attachment 2, Exhibit TBH-1, p. 2. As a result and as further discussed in sections 3 and 5  
12 below, forcing EWAZ to renegotiate or breach the agreements entered into with the  
13 landowners requesting service in these circumstances is unwarranted. See Decision No.  
14 74910 (1/22/2015) at 17 (declining to adopt Staff's recommendation that utility alter  
15 proposed funding of infrastructure for extension area given parent company's size and  
16 access to capital markets).

17 **3. EWAZ Objects to Staff's Recommended Refusal (No. 9) to Treat Funds**  
18 **Contributed by Developers/Landowners as Advances or Contributions in Aid**  
19 **of Construction.**

20 The funds due under the seventeen WFAs between the landowners requesting  
21 service and the Company's predecessor (also referred to as the "Earlier Agreements" by  
22 Staff) should be treated as AIAC or CIAC as outlined in the Application. As noted above,  
23 Staff's principal concern—that the inclusion of these funds adversely affects the  
24 Company's existing capital structure—is unsupported and actually belied by Staff's own  
25 Report.

26 With respect to Staff's position that the Earlier Agreements represent evidence of  
indebtedness, A.R.S. § 40-302 generally prohibits public service corporations from issuing

1 “stocks and stock certificates, bonds, notes and other evidences of indebtedness” without  
2 an order from the Commission. That statute does not address and is not applicable to the  
3 advance payments from developers under the WFAs (in place of an off-site hook-up fee  
4 that could not be accurately calculated because the lands are not yet fully platted for  
5 development). Such funds are not indebtedness of the Company. Rather, they are advance  
6 payments made by the developers to fund the common infrastructure necessary to  
7 implement a regional wastewater and recycled water solution for the Loop 303 area. The  
8 WFAs contain no commitment to repay any funds advanced, except to the extent such  
9 funds are eligible for refund pursuant to the terms of future line extension agreements  
10 between EWAZ and the landowners/developers (addressed in 5 below). The Company is  
11 thereby able to construct plant in service owned by the utility, with development risk  
12 appropriately shouldered by the developers. As a result, the WFAs do not constitute  
13 evidence of indebtedness and A.R.S. § 40-302 is inapplicable to those funds and  
14 agreements. See A.A.C. R14-2-602(B)(5)(p) (recognizing debt as separate manner of  
15 funding new construction from both AIAC and CIAC).

16 Staff’s own Report further demonstrates that the funds received pursuant to the  
17 Existing Agreements are not “indebtedness.” While Staff states that it “believes that the  
18 [on-site line extension agreements] and WFAs would be considered debt”, Report,  
19 Attachment 2, p. 4, Staff nonetheless recommends treating \$14,792,974 due to be  
20 advanced by developers pursuant to the on-site line extension agreements (required by the  
21 WFAs) as AIAC. Staff does not recommend that those funds, which are not materially  
22 different than the funds required to be advanced under the WFAs, be treated as debt,  
23 because such advances are not debt. If Staff’s position were to be adopted, every main  
24 extension agreement would require a Commission order prior to its execution. That  
25 position contradicts Commission practice and regulation. See A.A.C. R14-2-606 (no  
26

1 approval of wastewater collection main extension agreements required); Decision No.  
2 69671 (6/28/2007) at 3 (same).

3 EWAZ further objects to Staff's implied argument that EWAZ or its predecessor  
4 were required to obtain Commission approval of the WFAs or other agreements predating  
5 the Application. As the Commission has noted on previous occasions, wastewater main  
6 extension agreements do not require any Commission approval, see Decision No. 69671,  
7 and Staff has not identified any regulatory or statutory requirements mandating  
8 Commission approval of the WFAs in this instance, because there are none. See A.R.S.  
9 § 40-281 (only addressing construction of new facilities prior to issuance of CC&N). The  
10 WFAs are consistent with utility practices in Arizona and the business relationship  
11 between EWAZ and the landowners reflected in the WFAs should not be altered by the  
12 Commission.

13 **4. EWAZ Objects to Staff's Recommendation (No. 10) That all Funds Collected**  
14 **Pursuant to the Existing Agreements be Refunded.**

15 In addition to Staff recommending that the funds received from landowners in the  
16 area pursuant to the WFAs not be treated as AIAC or CIAC, Staff also recommends that  
17 such funds be refunded to the landowners/developers. Staff offers no basis for this  
18 recommendation. Instead, Staff asserts, without support, that such funds constitute "debt".  
19 Even if true, which as discussed above it is not, there is no statute or regulation that  
20 permits the Commission to order such funds be refunded. Under the plain terms of the  
21 WFAs, the landowners agreed to pay EWAZ's predecessor in interest fixed advances upon  
22 the occurrence of certain events, including obtaining the requested wastewater CC&N.  
23 Staff cites no basis in the Report for the recommendation that EWAZ be required to refund  
24 all such payments to the landowners/developers, because there is no basis in statute or  
25 regulation for such a recommendation. Accordingly, Staff's recommendation No. 10  
26 should be rejected.

1 **5. EWAZ Finally Objects to Staff's Recommendations (Nos. 11 and 12) That all**  
2 **Refunds Must Comply With A.A.C. R14-2-606.**

3 **A. The Refund Provision of R14-2-606 Does Not Apply to the WFAs.**

4 R14-2-606 applies only to "collection main extensions". Collection mains are  
5 defined as a "sewer main of the utility from which service collection lines are extended to  
6 customers." R14-2-601(7). EWAZ's predecessor in interest entered into the WFAs with  
7 the landowners requesting service in the Loop 303 area. Those agreements provide the  
8 mechanism to fund the common backbone infrastructure, such as the wastewater treatment  
9 plant and off-site trunk lines, necessary to provide wastewater treatment to the proposed  
10 certificated area. That infrastructure is not connected to service lines providing wastewater  
11 service to individual customers. As a result, the WFAs are not subject to the refund  
12 requirements contained in R14-2-606(C). Indeed, the Commission has previously allowed  
13 these types of backbone infrastructure agreements without prior Commission approval.  
14 See Decision Nos. 67105 (July 9, 2004) (recognizing pre-application agreement that  
15 required developer to pay Project Facilities fees for construction of off-site infrastructure);  
16 65757 (March 20, 2003) (similar). In those Decisions, the Commission allowed facility  
17 extension agreements with terms that differed markedly from the requirements of R14-2-  
18 606. See also Decision No. 64746 (April 17, 2002) (expressly approving wastewater  
19 extension agreement for common infrastructure that contained a single payment refund  
20 obligation triggered by individual service connections). As in the case of those earlier  
21 Decisions, the Commission should allow the negotiated provisions of the WFAs to stand.

22 **B. The Refund Provisions of the Collection Main Extension Agreements**  
23 **Attached to the WFAs Should be Approved by the Commission.**

24 A form of future collection main extension agreements is attached to the WFAs as  
25 Exhibit E. That form agreement provides for refunds that differ from those set out in R14-  
26 2-606(C). Specifically, the form of line extension agreement agreed to between the Loop

1 303 landowners and the Company's predecessor in interest requires the Company to refund  
2 2.5 percent of gross revenues received by EWAZ from the provision of sewer utility  
3 service to each customer within the applicable development for a period of 22 years  
4 starting the fourth year after the applicable development specific infrastructure is conveyed  
5 to EWAZ. The refunds are capped at the total amount of developer advances under the  
6 development specific extension agreement and the advances attributable to the  
7 development under the applicable WFA. R14-2-606(C)(5) limits refunds of advances to a  
8 term of five years. Staff's Report assumes that the future line extension agreements will be  
9 refunded at a level of ten percent of revenues received from customers over a period of  
10 five years apparently starting with the first service connection. TBH-2, p. 1, n. 7-8.  
11 However, there is no contractual basis for that refund scheme.

12 Implementation of Staff's refund recommendation would require the Company to  
13 successfully renegotiate each of the 17 WFAs with the Loop 303 landowners or breach the  
14 WFAs. It would also likely result in less rate base, long-term, than the Company's  
15 proposal, as a smaller amount of advanced funds would likely be refunded and rolled into  
16 rate base. Given Staff's stated concern with future rate base, Staff's refund  
17 recommendation is counterproductive and should be rejected. Furthermore, the  
18 Commission has previously approved extension agreements that were not in line with the  
19 terms contained in R14-2-606(C). See Decision Nos. 64746, supra.; 67830 (5/5/2005) at 5  
20 (wastewater main extension agreements that obligated utility to refund 2.5 percent of gross  
21 annual revenue to developer starting four years after facilities are accepted for 22 years  
22 "exceed the minimum refund standards required in the Commission's rules [and] are  
23 acceptable to Staff"). In the present case, the refund provisions of the line extension  
24 agreement were part of the negotiated regional approach to wastewater treatment. To the  
25 extent necessary, EWAZ requests that the Commission approve the terms of the proposed  
26 line extension agreements pursuant to R14-2-610(F). Given that the terms of the proposed

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1 line extension agreements were negotiated at arm's length between willing parties and are  
2 an integral part of the negotiated regional solution, Staff's recommendation that all refunds  
3 should comply with the terms of R14-2-606(C) should be rejected and the terms of the  
4 form agreement approved.

5 RESPECTFULLY SUBMITTED this 10th day of July, 2015.

6 LEWIS ROCA ROTHGERBER, LLP

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17 ORIGINAL AND thirteen (13) copies  
18 of the foregoing hand-delivered this  
19 10th day of July, 2015, to:

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22 1200 W. Washington Street  
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24 Copy of the foregoing hand-delivered  
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