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DOCKET NO. W-01732A-15-0131
DOCKET NO. W-01303A-15-0131

IN THE MATTER OF THE JOINT APPLICATION OF WILLOW VALLEY WATER CO., INC. AND EPCOR WATER ARIZONA INC. FOR APPROVAL OF THE SALE OF ASSETS AND TRANSFER OF CERTIFICATE OF CONVENIENCE AND NECESSITY.

STAFF'S NOTICE OF FILING DIRECT TESTIMONY

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") hereby files the Direct Testimony of Staff witnesss Gerald Becker and Jian Liu, in the above-captioned matter.

RESPECTFULLY SUBMITTED this 9th day of October, 2015.

[Signature]
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Attorney, Legal Division
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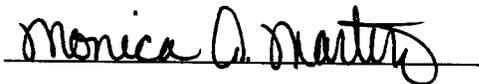
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BEFORE THE ARIZONA CORPORATION COMMISSION

SUSAN BITTER SMITH

Chairman

BOB STUMP

Commissioner

BOB BURNS

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IN THE MATTER OF THE JOINT)
APPLICATION OF WILLOW VALLEY)
WATER CO., INC. AND EPCOR WATER)
ARIZONA INC. FOR APPROVAL OF THE)
SALE OF ASSETS AND TRANSFER OF)
CERTIFICATE OF CONVENIENCE AND)
NECESSITY)
_____)

DOCKET NOS. W-01732A-15-0131
& W-01303A-15-0131

DIRECT

TESTIMONY

OF

GERALD BECKER

EXECUTIVE CONSULTANT

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

OCTOBER 9, 2015

TABLE OF CONTENTS

	Page
INTRODUCTION	1
SUMMARY OF TESTIMONY AND RECOMMENDATIONS	3
ACQUISITION PREMIUM / ACQUISITION ADJUSTMENT	4
DUE DILIGENCE WORKPAPERS	13
SYSTEM IMPROVEMENT BENEFIT MECHANISM	14
CAPITAL STRUCTURE	14
RECOMMENDATIONS.....	15

ATTACHMENTS

EWAZ General Objections	A
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EXECUTIVE SUMMARY
WILLOW VALLEY WATER COMPANY & EPCOR WATER ARIZONA, INC.
DOCKET NOS. W-01732A-15-0131 & W-01303A-15-0131

I am presenting Staff's recommendations regarding the transfer of Willow Valley Water Co., Inc. ("Willow Valley") to EPCOR Water Arizona Inc. ("EWAZ") (collectively, the "Applicants").

On April 23, 2015, Willow Valley and EWAZ filed an application to request that the Arizona Corporation Commission ("Commission") approve, pursuant to the Arizona Revised Statutes ("A.R.S.") §§ 40-281, 40-282, 40-285 and Arizona Administrative Code ("A.A.C.") R14-2-402, the sale of Willow Valley's utility system and transfer of its Certificate of Convenience and Necessity ("CC&N") to EWAZ. The application proposes that EWAZ will pay a price that is 10 percent in excess of the rate base value of Willow Valley. On June 1, 2015, EWAZ filed a supplement to the application to describe the proposed surcharge mechanism to subsequently fund the proposed acquisition premium by seeking a bonus incentive for certain prospective spending on the Willow Valley system.

Staff recommends approval of the transaction subject to the following conditions:

1. That the Commission deny recognition of any acquisition premium that EWAZ pays for Willow Valley,
2. That the Commission deny recognition of any acquisition adjustment or other premium to be applied to expenditures required in the ordinary course of business,
3. Because of the recent Court of Appeals opinion, which set aside the Commission's approval of a System Improvement Benefit ("SIB") mechanism that was materially identical to the SIB approved for Willow Valley in Decision No. 74364, it is necessary to stay the implementation of the SIB mechanism, along with all compliance matters related to the SIB mechanism as set forth in the Plan of Administration if not already done so, pending the outcome of further court proceedings,
4. That EWAZ be put on notice that Willow Valley should work towards balanced capital structure and that a hypothetical capital structure may be deemed in a future rate proceeding if EWAZ fails to do so,
5. In its next full rate case, EWAZ shall include a regulatory liability of \$260,224 to make the ratepayers whole for the effects of the net Accumulated Deferred Income Tax liability that is being retained by Global Water Resources, Inc. EWAZ shall also propose an amortization methodology not to exceed five years for the regulatory liability in its next full rate case, and
6. EWAZ shall continue to comply with all decisions, and more specifically the requirements of Decision No. 74364 which annual requires reporting of the Willow Valley's water losses until such at time as annual water losses is less than 10 percent.

1 **INTRODUCTION**

2 **Q. Please state your name, occupation, and business address.**

3 A. My name is Gerald Becker. I am an Executive Consultant III employed by the Arizona
4 Corporation Commission ("Commission") in the Utilities Division ("Staff"). My business
5 address is 1200 West Washington Street, Phoenix, Arizona 85007.

6
7 **Q. Briefly describe your responsibilities as an Executive Consultant III.**

8 A. I am responsible for the examination and verification of financial and statistical information
9 included in utility rate applications. In addition, I develop revenue requirements, and prepare
10 written reports, testimonies, and schedules that include Staff recommendations to the
11 Commission. I am also responsible for testifying at formal hearings on these matters.

12
13 **Q. Please describe your educational background and professional experience.**

14 A. I received a Master's of Business Administration with an emphasis in Accounting from Pace
15 University. I am a Certified Public Accountant and a Certified Internal Auditor.

16
17 I have participated in multiple rate, financing and other regulatory proceedings. I attended
18 the National Association of Regulatory Utility Commissioners ("NARUC") Utilities Rate
19 School.

20
21 I began employment with the Commission as a utilities regulatory analyst in April 2006. Prior
22 to joining the Commission, I worked as an Auditor at the Department of Economic Security
23 and Department of Revenue in the Taxpayer Assistance Section. Prior to those jobs, I
24 worked for 15 years as an Auditor, Analyst, Financial Analyst, and Budget Manager at United
25 Illuminating, an investor-owned electric company in New Haven, CT.

26

1 **Q. What is the scope of your testimony in this case?**

2 A. On April 23, 2015, Willow Valley Water Co., Inc. ("Willow Valley") and EPCOR Water
3 Arizona, Inc. ("EWAZ") (collectively, the "Applicants") filed an application to request that
4 the Commission approve, pursuant to the Arizona Revised Statutes ("A.R.S.") §§ 40-281, 40-
5 282, 40-285 and Arizona Administrative Code ("A.A.C.") R14-2-402, the sale of Willow
6 Valley's utility system and transfer of its Certificate of Convenience and Necessity ("CC&N")
7 to EWAZ. The application proposes that EWAZ will pay a price that is in excess of the rate
8 base value of Willow Valley. On June 1, 2015, EWAZ filed a supplement to the application
9 to describe the proposed surcharge mechanism to fund the proposed acquisition premium
10 and to request a bonus incentive on prospective amounts spent on Willow Valley. I am
11 presenting Staff's recommendations regarding the transfer of Willow Valley to EWAZ.

12
13 Willow Valley is a subsidiary of Global Water Resources, Inc. ("Global"). Present rates were
14 set in Docket No. W-01732A-12-0315 which resulted in Decision No. 74364, dated February
15 26, 2014. This decision was the result of a settlement agreement and resulted in a revenue
16 increase of \$404,269, or 57.53 percent, over test year revenues of \$507,537, for total approved
17 revenues of \$1,106,922.¹ This revenue increase is phased in over 2 years beginning in 2015.
18 Decision No. 74364 also approved a System Improvement Benefit ("SIB") mechanism to
19 address, in part, the 23.40 percent water loss in Willow Valley during its test year, along with
20 other necessary repairs to the distribution system.

21
22 **Q. What is the basis of your recommendations?**

23 A. I have reviewed the joint application of EWAZ and Willow Valley whereby EWAZ would
24 acquire certain assets of Willow Valley. I compared the application with the terms and
25 conditions attached to reorganizations approved by the Commission and other regulatory

¹ See Decision No. 74364, Settlement Schedule A-1, for Willow Valley.

1 bodies to ensure adequate protections exist for the ratepayers along with evaluating the
2 amount of benefits that would accrue to the ratepayers as a result of the proposed transfer of
3 assets.

4
5 **SUMMARY OF TESTIMONY AND RECOMMENDATIONS**

6 **Q. Please summarize Staff's recommendations.**

7 A. Staff recommends approval of the transfer subject to certain conditions which are intended to
8 benefit and protect ratepayers. These conditions include:

- 9
- 10 1. That the Commission deny recognition of any acquisition premium that it pays for
11 Willow Valley,
 - 12 2. That the Commission deny recognition of any acquisition adjustment or other
13 premium to be applied to expenditures required in the ordinary course of business,
14 Because of the recent Court of Appeals opinion, which set aside the Commission's
15 approval of a SIB mechanism that was materially identical to the SIB approved for
16 Willow Valley in Decision No. 74364, it is necessary to stay the implementation of the
17 SIB mechanism, along with all compliance matters related to the SIB mechanism as
18 set forth in the Plan of Administration if not already done so, pending the outcome of
19 further court proceedings,
 - 20 3. That EWAZ be put on notice that Willow Valley should work towards balanced
21 capital structure and that a hypothetical capital structure may be deemed in a future
22 rate proceeding if EWAZ fails to do so,
 - 23 4. In its next full rate case, EWAZ shall include a regulatory liability of \$260,224 to make
24 the ratepayers whole for the effects of the net Accumulated Deferred Income Tax
25 liability that is being retained by Global. EWAZ shall also propose an amortization

1 methodology not to exceed five years for the regulatory liability in its next full rate
2 case, and

- 3 5. EWAZ shall continue to comply with all decisions, and more specifically the
4 requirements of Decision No. 74364 which annual requires reporting of the Willow
5 Valley's water losses until such at time as annual water losses is less than 10 percent.
6

7 **ACQUISITION PREMIUM / ACQUISITION ADJUSTMENT**

8 **Q. Is the Company proposing an acquisition premium?**

- 9 A. Yes. The Companies are proposing a ten percent acquisition premium of \$226,803 which
10 they claim to represent 10 percent of Willow Valley's rate base.
11

12 **Q. Does Staff support the proposed acquisition premium in this proceeding?**

- 13 A. No. The proposed transfer of Willow Valley from Global to EWAZ does not warrant
14 payment of or regulatory recognition of an acquisition premium. Global, Willow Valley's
15 parent, is a Class A, well capitalized utility company with access to the operational expertise as
16 well as the capital necessary to own and operate Willow Valley. Accordingly, a transfer of
17 ownership does not represent significant benefits to the ratepayers of Willow Valley.
18

19 On February 26, 2014, Willow Valley was granted a SIB in Decision No. 74364 due to its
20 aging infrastructure which has undoubtedly contributed to a 23.40 percent water loss as noted
21 in Willow Valley's most recent rate proceeding. Willow Valley has not undertaken SIB
22 eligible necessary capital replacements to the system. In fact, the water loss has risen to 26.1
23 percent.² Due to the state of the infrastructure at Willow Valley and Global's failure to
24 mitigate its water losses, Staff recommends that the Commission be mindful not to create an
25 incentive for those who fail to maintain water systems to propose to sell those systems at an

² See Compliance filing of Willow Valley Water Company in Docket No. W-01732A-15-0131, May 29, 2015.

1 amount in excess of its rate base value. Further, the applicants have not presented any
2 evidence that the “goodwill” or “going concern value” in excess of the book value is of any
3 benefit to the ratepayers. Further, and in response to Residential Utility Consumer Office
4 (“RUCO”) data request 2.05, Willow Valley states that there are no present problems with the
5 water quality or provision of service that would be addressed by the proposed transfer.
6

7 **Q. Does Staff agree with the Companies’ calculation of the acquisition premium that**
8 **they are proposing?**

9 A. No. The Companies propose an acquisition premium equal to 10 percent of the EWAZ’s re-
10 calculation of rate base which excludes certain components customarily included in a rate
11 base calculation. The amounts proposed to be excluded are Accumulated Deferred Income
12 Tax (“ADIT”) Credit of \$293,862, an ADIT Debit of \$33,638,³ and Customer Deposits of
13 \$31,898, the net of which is a misstatement of Willow Valley’s rate base in the amount of
14 \$292,122. By excluding these items, the Companies overstate the value of the Willow Valley
15 and understate the proposed acquisition premium by \$335,532, as discussed and shown
16 below.
17

18 **Q. Please describe and provide the Company’s calculation of the value being transferred,**
19 **the purchase price, and the proposed acquisition premium.**

20 A. In response to Staff data request GWB 1.1, EWAZ used its rate base methodology to
21 determine a rate base of \$2,268,031, plus a 10 percent acquisition premium, to support the
22 purchase price of \$2,494,834 as shown below:
23

³ Net ADIT is equal to \$260,224.

Descriptions	EPCOR Purchase Price Calculation as of 12-31-2014	
Utility Plant in Service	\$5,146,109	
CWIP	<u>\$19,767</u>	
Total PP&E	\$5,165,876	
Accumulated Depreciation	<u>(\$2,369,499)</u>	
Gross Plant	\$2,796,377	(more correctly defined as 'net plant')
AIAC	(\$69,347)	
CIAC	<u>\$458,999</u>	
Net Rate Base	\$2,268,031	
With 10% Acquisition Premium	<u>1.10</u>	(or \$226,803 acquisition premium)
Purchase Price	\$2,494,834	

1
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5
6

Q. Does Staff agree with the Applicants' rate base calculation shown above?

A. No. In response to Staff data request GWB 1.6, Global, the parent of Willow Valley, provided a schedule of its rate base as of December 31, 2011⁴, totaling \$2,278,955, and the rate base as of December 31, 2014, totaling \$1,964,397, as shown below.

⁴ December 31, 2011, was the end of the test year in Willow Valley's most recent rate case in Docket No. W-01732A-12-0315, Decision No. 74364.

1

	12/31/2011	12/31/2014
Plant in Service	\$ 5,033,102	\$ 5,168,988
2 Less: Accumulated Depreciation	(1,742,556)	(2,384,123)
3 Net Plant in Service	<u>\$ 3,290,546</u>	<u>\$ 2,784,864</u>
 <i>LESS:</i>		
4 Contributions in Aid of Construction (CAIC) \$		\$ 537,430
5 Less: Accumulated Amortization		(78,432)
6 Net CAIC		<u>458,999</u>
7 Advances in Aid of Construction (AIAC)	610,760	69,347
8 Imputed Reg AIAC		
9 Imputed Reg CAIC		
10 Accumulated Deferred Income Tax Credits	391,114	293,862
11 Customer Meter Deposits	36,233	31,898
 <i>ADD:</i>		
12 Accumulated Deferred Income Tax Debits	26,516	33,638
13 Cash Working Capital		
14 Purchase Wastewater Treatment Charges		
Original Cost Rate Base	<u>2,278,955</u>	<u>1,964,397</u>

3

4

Q. Please identify and discuss the differences in the rate base calculations.

5

A. As indicated above and in its response to Staff data request GWB 1.1, the EWAZ indicates
6 net rate base of \$2,268,031, as compared with the net rate base of \$1,964,397 provided in
7 response to Staff data request GWB 1.6, for a difference of \$303,634. Most of this
8 (\$292,122) is due to the omission of ADIT amounts with net amount of \$260,224, plus
9 Customer Deposits of \$31,898, for a total of \$292,122 in EWAZ's calculation of the rate base
10 provided in response to Staff data request GWB 1.1. There is also an unexplained difference
11 of \$11,513⁵ in the net plant amounts provided by EWAZ due to different amounts being
12 provided in EWAZ's response to GWB1.1 and the response of Global to Staff data Request
13 GWB 1.6. Adding the \$292,122 difference for ADIT and Customer Deposit to the \$11,513
14 unreconciled difference for the plant balances equals the difference of \$303,634.

⁵ In EWAZ's response to Staff data request GWB1.1, the Company indicates net plant of \$2,796,377, as compared with the net plant of \$2,784,864 in Global's response to Staff data request GWB1.6, for a difference of \$11,513.

1 The failure to recognize the ADIT (which represents funds already provided by customers)
2 and correct plant balances means that the proposed acquisition premium of \$226,803 is
3 understated by \$335,532, for total proposed acquisition premium of \$562,335, as shown
4 below. In response to a RUCO data request, Willow Valley will refund customer deposits to
5 its customers after the transfer. Accordingly, the acquisition premium would be calculated
6 based on a comparison of the adjusted rate bases of \$1,932,499 (\$1,964,397 less \$31,898
7 customer deposits) with the proposed price of \$2,494,834, for an acquisition premium of
8 \$562,335, or 29.1 percent of the adjusted rate base of \$1,932,499⁶.

9		
10	Purchase Price, per GWB1.1	\$2,494,834
11	Rate Base, Per GWB 1.6	\$1,964,397
12	Less Customer Deposits	<u>\$ 31,898</u>
13	Adjusted Rate Base	\$1,932,499
14	Acquisition Premium	\$ 562,335 or 29.1 percent
15	Acquisition Premium, per applicants	<u>\$ 226,803</u>
16	Understatement of Acquisition Premium	\$ 335,532
17		

18 **Q. Please explain the reasons to use the corrected rate base to determine the proposed**
19 **acquisition premium.**

20 A. Although EWAZ's calculation provided in response to Staff data request GWB 1.1 may
21 reflect the terms of the asset purchase agreement between the Applicants, such calculation
22 would deprive the ratepayers of valuable ratepayer benefits. First, the exclusion of ADIT
23 deprives ratepayers of the benefits of amounts provided to the regulated utility through
24 income tax expense but not yet remitted to the taxing authorities. Such amounts represent a
25 source of non-investor supplied capital to the regulated entity and are properly included in

⁶ Response of Global Water Resources, Inc. to Staff data request GWB1.6 indicated a rate base of \$1,964,397, less customer meter deposits of \$31,898, for a net of \$1,932,499.

1 rate base calculations. Second, customer deposits also represent non-investor funds supplied
2 to the regulated entity and which should also be reflected in the rate base calculation in this
3 proceeding as well as in future rate cases. In response to RUCO data request 2.02, the
4 Applicants state that customer deposits will be returned to customers upon closing the
5 transaction. The logistical and operational concern involves the repayment of those monies
6 to ratepayers and the increased risk of bad debt expense that may accompany that practice.
7 In the past judgment of Willow Valley, certain customers were required to post security
8 deposits to guarantee payment of bills. Failure to retain those amounts puts the rest of the
9 customers at greater risk of uncollectible amounts which would be absorbed by the other
10 customers in a future rate case. Third, the correct net plant balances should be used in the
11 calculation of the values to be transferred as well as in the calculation of any acquisition
12 premium that might be approved in this proceeding.

13
14 **Q. What does Staff recommend regarding the ADIT?**

15 A. If the proposed transfer is approved, Staff recommends that EWAZ establish a regulatory
16 liability in its next full rate case in the amount of \$260,224 to provide benefits to the
17 ratepayers who would have benefitted if the net ADIT balance had been transferred to the
18 buyer. A net ADIT liability represents income taxes previously paid by the ratepayers but not
19 yet remitted by the utility company, and in effect, is a source of non-investor capital that is
20 recognized in rate base calculations and result in a reduction to the rate base. The proposal
21 not to transfer the ADIT balances to the buyer should be accepted only if the ratepayers are
22 made whole for rate base reduction associated with the net ADIT liability by establishing a
23 regulatory liability in the next full rate case. EWAZ should also propose a methodology to
24 amortize the regulatory liability in its next full rate case.

1 **Q. What does Staff recommend regarding the acquisition premium?**

2 A. In response to Staff data requests, EWAZ was unable to provide a quantification of any
3 benefits expected to accrue to the ratepayers as a result of the transfer of these assets to them.
4 Accordingly, there is no justification to support an acquisition premium to be borne by the
5 ratepayers.

6
7 **Q. Are there other benefits that are not being shared with the ratepayers?**

8 A. Yes. The transfer of assets means that those assets will now be supported by capital from
9 EWAZ which has a capital structure that is more favorable to the ratepayers (i.e., less equity).
10 This is based on a comparison of the capital structure approved in Willow Valley's most
11 recent rate case in Docket No. W-01732A-15-0131 and the capital structure proposed by
12 EWAZ in its most recent rate case (WS-01303A-14-0010). Staff has recalculated the revenue
13 requirements for Willow Valley by supplanting Willow Valley's capital structure with
14 EWAZ's⁷ and found this could result in a reduction to the revenue requirements of
15 approximately \$29,000 per year. This potential reduction is a ratepayer benefit that should
16 accrue to the ratepayers to reduce the \$404,269, or 57.53 percent increase approved in Willow
17 Valley's most recent rate case. This reduction represents monies available to EWAZ to make
18 necessary improvements to the system, and further precludes the need for any extraordinary
19 ratemaking treatment of monies that need to be expended on Willow Valley. The capital
20 structure will not align until EWAZ's next rate case concludes.

21

⁷ Revenue requirements recalculated for Willow Valley using a weighted average cost of equity of 3.82 percent and a weighted average cost of debt of 2.56 percent, for a total cost of capital of 6.38 percent, per Decision No. 75268 in Docket No. WS-01303A-14-0010. This would result in a required revenue increase of \$375,537 as compared with the increase of \$404,269 in Decision No. 74364 in Docket No. W-01732-12-0315, a difference of \$28,732.

1 **Q. Have the Companies identified and quantified any benefits in support of the**
2 **proposed acquisition premium?**

3 A. No. In its response to Staff data request GWB 1.3, EWAZ is unable to identify and quantify
4 the value of specific quantifiable benefits for the ratepayers for approving the transaction.
5 EWAZ provides only general statements regarding its ability to provide service, and EWAZ
6 does not identify and assign a value to any specific improvement that will benefit the
7 ratepayers of Willow Valley. Further, in response to RUCO data request 2.05, Willow Valley
8 states that it is presently providing safe and reliable drinking water, and this would suggest
9 that there are no present deficiencies that would be corrected only by the transfer.

10
11 **Q. In addition to an acquisition premium, is EWAZ proposing an acquisition**
12 **adjustment?**

13 A. Yes, in addition to an acquisition premium based on the excess of the purchase price over its
14 incomplete calculation of Willow Valley's book value discussed above, EWAZ is proposing
15 an acquisition adjustment on prospective capital investments to be made to the system, as
16 discussed in its supplement of June 1, 2015 to the application. EWAZ proposes that it
17 should receive a bonus of 10 to 20 percent over the actual cost of investments that will be
18 made to the system. In its application, EWAZ estimates to spend approximately \$1,000,000
19 over 5 years for projects not outlined in the existing SIB, and these projects might include,

- 20
21 1) a system interconnect between the King Street and Lake Cimarron areas of the
22 existing Willow Valley system to provide operational flexibility and redundancy,
23 2) replacement of system valves that are currently non-operational, 3) a more
24 robust backwash effluent discharge retention system to prevent leaching into the
25 aquifer, 4) necessary maintenance of three storage tanks, and 5) replacement or
26 repair of failed flow and backwash meters and other infrastructure projects.⁸

27

⁸ See Supplement to Application, dated June 1, 2015, 5 at 1-7.

1 **Q. What are Staff's comments regarding the proposed acquisition adjustment?**

2 A. First, the proposed underlying spending plan does not warrant special ratemaking treatment.
3 Maintenance of storage tanks are typically considered as part of a utility's routine operating
4 and maintenance expenses. Moreover, expenditures necessary to keep a utility in good repair
5 are part of the normal course of utility operations and accordingly do not warrant a premium
6 to be paid to a utility for meeting its basic obligations regarding the provision of service.
7 EWAZ has not identified any specific operational deficiency that would be solved by
8 interconnecting Willow Valley's two areas, each of which already has multiple wells that can
9 be used as sources of production⁹. Accordingly, Staff recommends the denial of the
10 acquisition adjustment.

11
12 Further, Staff would note that the revenue calculations on the bonus to be applied to the
13 EWAZ's investment¹⁰ reflects EWAZ's cost of capital, not the cost of capital approved in
14 Decision No. 74364 for the most recent Willow Valley case in Docket No. W-01732A-12-
15 0315, and the stated expected monthly cost to the ratepayers reflect the bonus only and not
16 the totality of the investment. The Company's stated bill impact of \$1.21, or 2.22 percent¹¹
17 per month per customers supports only the bonus proposed by the Company. The
18 Company's proposal would result in a total increase to the bill of a customer using 5,000
19 gallons per month of \$7.27, or 16.78 percent, from \$43.33 to \$50.60. This increase is in
20 addition to the increase approved in Decision No. 74364 which increases the bill of a
21 customer using 5,000 gallons per month by \$14.82, or 52.0 percent, from \$28.51 to \$43.33.

⁹ See Staff Engineering Testimony of Jian Liu filed on July 8, 2013 in Docket No W-01732A-12-0315.

¹⁰ See Supplement to Application dated June 1, 2015, 4 at 17-23. i.e. required Annual Operating Income Produced of \$6,740 on a \$100,000 Authorized Incentive, for an rate of return of 6.74 percent, as compared with 7.50 percent rate of return approved in Decision No. 74568 in Docket No. W-01732A-12-0315.

¹¹ EWAZ incorrectly used \$54.66 for its monthly bill to a customer using 5,000 gallons per month. The correct bill is \$43.33 to reflect the "CRT" reduction of \$11.33 from the unadjusted amount of \$54.66, for a corrected percentage increase of 2.79 percent (\$1.21 divided by \$43.33). In Docket No W-01732A-12-0315, the Commission approved a Conservation Rebate Threshold or "CRT" providing a 50 percent discount applied to the volumetric component of customers' bills for all bills less than or equal to 6,000 gallons per month.

1 The combined impact of the recent rate decision and EWAZ's proposal in the instant
2 proceeding would increase of a customer using 5,000 gallons per month by \$22.09, or 77.48
3 percent, from \$28.51 to \$50.60. The overall increase of \$22.09, or 77.48 percent, is
4 significantly higher than the \$1.21 per month represented by the Company.
5

6 **DUE DILIGENCE WORKPAPERS**

7 **Q. Did Staff request access to EWAZ's due diligence workpapers related to its purchase**
8 **of Willow Valley?**

9 **A. Yes. In Staff data request GWB 1.1 e.¹², Staff requested access to the EWAZ's due diligence**
10 **workpapers supporting its decision to buy Willow Valley¹³. In addition the general objections**
11 **to all of Staff's data requests,¹⁴ EWAZ responded,**

12 “EWAZ objects to STF GWB 1.1e to the extent that it seeks information that is
13 not reasonably calculated to lead to the discovery of admissible evidence.
14 EWAZ further objects to STF GWB 1.1e to the extent that it seeks information
15 protected by the attorney-client privilege, the work-product doctrine or any other
16 privilege recognized under law. EWAZ also objects to STF GWB 1.1e to the
17 extent that it seeks highly confidential business information or trade secrets.
18

19
20 However, EWAZ subsequently reconsidered Staff's request and provided Staff with access to
21 its due diligence workpapers. Based on its review of those workpapers, Staff has no concerns
22 specific to the Company's due diligence.
23

¹² See Attachment 1, Staff data request GWB1.1

¹³ Staff has requested and was provided access to the due diligence workpapers in other proceedings, such as the recent acquisition of UNS Energy by Fortis, Inc. in Docket Nos. E-01933A-14-0011 and E-04230A-14-0011.

¹⁴ See Attachment 2, EWAZ's General Objections To All Data Requests

1 **SYSTEM IMPROVEMENT BENEFIT MECHANISM**

2 **Q. What is the status of the SIB that was awarded to Willow Valley Decision No. 74364?**

3 A. Decision No. 74364 awarded a SIB to Willow Valley to address its aging infrastructure and
4 indirectly, its 23.40 percent water loss. Accordingly to the compliance report filed on May 29,
5 2015, the 12 month water loss for Willow Valley has increased to 26.1 percent. The
6 compliance report further states that Willow Valley has not implemented any SIB related
7 repairs, prior to the SIB being stayed by the AZ Court of Appeals.

8
9 Staff recommends that because of the recent Court of Appeals opinion, which set aside the
10 Commission's approval of a SIB mechanism that was materially identical to the SIB approved
11 for Willow Valley in Decision No. 74364, it is appropriate to stay the implementation of the
12 SIB mechanism, along with all compliance matters related to the SIB mechanism as set forth
13 in the Plan of Administration, pending the outcome of further court proceedings. EWAZ
14 should however file annual reports detailing Willow Valley's current water loss until such time
15 when the annual water losses are less than 10 percent.

16
17 **CAPITAL STRUCTURE**

18 **Q. Please describe the proposed funding of the transaction.**

19 A. The application states that EWAZ will fund the purchase of Willow Valley in cash. There is
20 no indication of any debt to be assumed or executed, and the application does not discuss the
21 specific capital structure that will arise as a result of the transaction.

22
23 **Q. Does Staff have any concerns regarding the resulting capital structure?**

24 A. Yes. Staff is concerned the description of the transaction might result in EWAZ taking the
25 position that Willow Valley is supported by 100 percent equity in a future rate case. In Staff
26 data request GWB 1.7, Staff attempted to determine the capital structure that EWAZ is

1 expecting to exist for Willow Valley if the proposed transaction is approved by the
2 Commission:

3
4 Q. Please explain the capital structure that would result if (from) the proposed
5 transfer to EPCOR.

6
7 EWAZ declined to provide a definite answer, stating in part,

8
9 A. "EWAZ objects to DR GWB 1.7 to the extent that it is not reasonably
10 calculated to lead to the discovery of admissible evidence. EPCOR also
11 objects to DR GWB 1.7 to the extent that it is vague and ambiguous and calls
12 for speculation..."

13
14 Staff recommends that the Commission put EWAZ on notice that Willow Valley should
15 work towards having a balanced capital structure and that utilization of a hypothetical capital
16 structure may be recommended in a future rate proceeding if EWAZ fails to do so. Staff
17 assumes Willow Valley's capital structure will be identical to that of EWAZ's other districts.

18
19 **RECOMMENDATIONS**

20 **Q. Based on the above, what is Staff recommending?**

21 A. Staff recommends approval of the transaction subject to the following conditions:

- 22
23 1. That EWAZ shall refrain from seeking rate recognition of any acquisition premium
24 that it pays for Willow Valley,
25 2. That EWAZ shall refrain from seeking rate recognition of any acquisition adjustment
26 or other premium to be applied to expenditures required in the ordinary course of
27 business,
28 3. Because of the recent Court of Appeals opinion, which set aside the Commission's
29 approval of a SIB mechanism that was materially identical to the SIB approved for

1 Willow Valley in Decision No. 74364, it is appropriate to stay the implementation of
2 the SIB mechanism, along with all compliance matters related to the SIB mechanism
3 as set forth in the Plan of Administration, pending the outcome of further court
4 proceedings,

5 4. That EWAZ be put on notice that Willow Valley should work towards balanced
6 capital structure and that a hypothetical capital structure may be deemed in a future
7 rate proceeding if EWAZ fails to do so,

8 5. In its next full rate case, EWAZ shall include a regulatory liability of \$260,224 to make
9 the ratepayers whole for the effects of the net Accumulated Deferred Income Tax
10 liability that is being retained by Global. EWAZ shall also propose an amortization
11 methodology not to exceed five years for the regulatory liability in its next full rate
12 case, and

13 6. EWAZ shall continue to comply with all decisions, and more specifically the
14 requirements of Decision No. 74364 which annual requires reporting of the Willow
15 Valley's water losses until such at time as annual water losses is less than 10 percent.
16

17 **Q. Does this conclude your direct testimony?**

18 **A. Yes, it does.**

**EPCOR WATER ARIZONA, INC.'S GENERAL OBJECTIONS
TO STAFF'S FIRST SET OF DATA REQUESTS
DOCKET NO. W-01732A-15-0131**

GENERAL OBJECTIONS TO ALL DATA REQUESTS

1. Epcor Water Arizona, Inc. ("EWAZ") objects to each Request to the extent it seeks information subject to the attorney-client privilege, work product doctrine or any other privilege recognized by the State of Arizona. In responding to these Requests, EWAZ preserves all such privileges.
2. EWAZ objects to each Request to the extent that it is unreasonably burdensome, overly broad and/or not reasonably calculated to lead to the discovery of admissible evidence.
3. EWAZ objects to each Request to the extent it calls for speculation.
4. EWAZ objects to each definition and/or instruction to the extent it purports to abrogate any of EWAZ's rights, or adds to any of EWAZ's obligations under, the Arizona Rules of Civil Procedure or the Commission's Rules.
5. EWAZ objects to each Request to the extent that it is overly broad, unduly burdensome and imposes any burden not expressly permitted under the Commission's Rules or the Arizona Rules of Civil Procedure.
6. EWAZ objects to each Request to the extent that the information requested constitutes "trade secrets" that are privileged under the Arizona Uniform Trade Secrets Act, Ariz. Rev. Stat. § 44-401, et. seq. (2003).
7. EWAZ objects to each Request to the extent it seeks information not within EWAZ's possession, control, or custody and/or to the extent the Requests ask EWAZ to provide information that it does not maintain in the ordinary course of business.
8. EWAZ objects to each Request to the extent it calls for a legal conclusion.
9. EWAZ reserves the right to supplement or amend its objections and responses as necessary.

BEFORE THE ARIZONA CORPORATION COMMISSION

SUSAN BITTER SMITH
Chairman
BOB STUMP
Commissioner
BOB BURNS
Commissioner
DOUG LITTLE
Commissioner
TOM FORESE
Commissioner

IN THE MATTER OF THE JOINT)
APPLICATION OF WILLOW VALLEY)
WATER CO., INC. AND EPCOR WATER)
ARIZONA INC. FOR APPROVAL OF THE)
SALE OF ASSETS AND TRANSFER OF)
CERTIFICATE OF CONVENIENCE AND)
NECESSITY)
_____)

DOCKET NOS. W-01732A-15-0131
& W-01303A-15-0131

DIRECT
TESTIMONY
OF
JIAN W. LIU
UTILITIES ENGINEER
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

OCTOBER 9, 2015

TABLE OF CONTENTS

	<u>PAGE</u>
INTRODUCTION	1
PURPOSE OF TESTIMONY.....	2
RECOMMENDATIONS AND CONCLUSIONS.....	3

EXHIBIT JW

Engineering Report for Willow Valley Water Co.....	JW
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1 **INTRODUCTION**

2 **Q. Please state your name, place of employment and job title.**

3 A. My name is Jian W. Liu. My place of employment is the Arizona Corporation Commission
4 ("ACC" or "Commission"), 1200 West Washington Street, Phoenix, Arizona 85007. My job
5 title is Water/Wastewater Engineer with the Commission's Utilities Division Staff ("Staff").

6
7 **Q. How long have you been employed by the Commission?**

8 A. I have been employed by the Commission since October 2005.

9
10 **Q. Please list your duties and responsibilities.**

11 A. My main responsibilities are to inspect, investigate and evaluate water and wastewater
12 systems. This includes obtaining data, preparing reconstruction cost new and/or original cost
13 studies, investigative reports, interpreting rules and regulations, and suggesting corrective
14 action and providing technical recommendations on water and wastewater system
15 deficiencies. I also provide written and oral testimony in rate cases and other cases before the
16 Commission.

17
18 **Q. How many companies have you analyzed for the Utilities Division?**

19 A. I have analyzed approximately 50 companies fulfilling these various responsibilities for the
20 Commission's Utilities Division.

21
22 **Q. Have you previously testified before this Commission?**

23 A. Yes, I have testified before the Commission.

24

1 **Q. What is your educational background?**

2 A. I am a Ph.D. Candidate in Geotechnical Engineering from Arizona State University ("ASU").
3 I have a Master of Science Degree in Natural Science from ASU and a Master of Science
4 Degree in Civil Engineering from Institute of Rock & Soil Mechanics ("IRSM"), Academy of
5 Sciences, China.

6
7 **Q. Briefly describe your pertinent work experience.**

8 A. From 1982 to 2000, I was employed by IRSM, SCS Engineers, and URS Corporation as a
9 Civil and Environmental Engineer. In 2000, I joined the Arizona Department of
10 Environmental Quality ("ADEQ"). My responsibilities with ADEQ included review and
11 approval of water distribution systems, sewer distribution systems, and on-site wastewater
12 treatment facilities. I remained with ADEQ until transferring to the Commission in October
13 2005.

14
15 **Q. Please state your professional membership, registrations, and licenses.**

16 A. I am a licensed professional civil engineer in the State of Arizona.
17

18 **PURPOSE OF TESTIMONY**

19 **Q. What was your assignment in this proceeding?**

20 A. My assignment was to provide Staff's engineering evaluation of the application. I reviewed
21 the Company's application and responses to data requests. This testimony and its attachment
22 present Staff's engineering evaluation. The findings of my engineering evaluation are
23 contained in the Engineering Report that I have prepared for this proceeding. The report is
24 included as Exhibit JWL in this pre-filed testimony.
25

1 **RECOMMENDATIONS AND CONCLUSIONS**

2 **Q. What are Staff's conclusions and recommendations regarding the Company's**
3 **operations?**

4 A. Staff's conclusions and recommendations regarding the Company's operations are contained
5 in the attached Engineering Report.

6
7 **Q. Does this conclude your Direct Testimony?**

8 A. Yes, it does.

EXHIBIT JW L

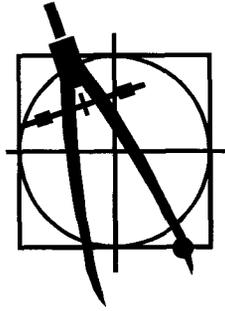
ENGINEERING REPORT FOR

WILLOW VALLEY WATER CO., INC.

DOCKET NOS. W-01732A-15-0131 AND W-01303A-15-0131

JIAN W LIU

OCTOBER 7, 2015



**ENGINEERING REPORT for:
Joint Application of Willow Valley Water
Co., Inc. and EPCOR Water Arizona Inc.
for Approval to Sale the Assets and
Transfer of the Certificate of Convenience
and Necessity
Docket Nos. W-01732A-15-0131 and W-
01303A-15-0131**

By: Jian W Liu, Utilities Engineer

OCTOBER 7, 2015

EXECUTIVE SUMMARY

CONCLUSIONS:

1. The Arizona Department of Environmental Quality (“ADEQ”) reported that the Willow Valley water systems are currently delivering water that meets water quality standards required by 40 C.F.R. 141 (National Primary Drinking Water Regulations) and Arizona Administrative Code, Title 18, Chapter 4.
2. Willow Valley Water Co., Inc. (“Willow Valley”) is not located within an Arizona Department of Water Resources (“ADWR”) Active Management Area (“AMA”) and is not subject to any ADWR AMA reporting and conservation requirements. ADWR has determined that Willow Valley is currently in compliance with departmental requirements governing water providers and/or community water systems.
3. A check with the Arizona Corporation Commission (“ACC” or “Commission”) Utilities Division Compliance Section showed no delinquent compliance items for the Willow Valley.
4. Staff concludes that Willow Valley water systems have adequate production capacity and storage capacity to serve the existing customer base and reasonable growth.

RECOMMENDATION

1. Staff recommends that EPCOR Water Arizona Inc. (“EWAZ”) prepare a report containing a detailed analysis and plan to reduce water loss to 10 percent or less for Willow Valley water systems. If the EWAZ believes it is not cost effective to reduce the water loss to less than 10 percent, it should submit a detailed cost benefit analysis to support its opinion. In no case shall the EWAZ allow water loss to be greater than 15 percent. The water loss reduction report or the cost benefit analysis shall be docketed as a compliance item within 90 days of the effective date of the order issued in this proceeding if this application is approved.

TABLE OF CONTENTS

	Page
A. INTRODUCTION	1
B. WATER SYSTEM.....	1
Water Loss	2
C. ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY (“ADEQ”) COMPLIANCE.....	2
E. ARIZONA DEPARTMENT OF WATER RESOURCES (“ADWR”) COMPLIANCE.....	2
F. ACC COMPLIANCE.....	3
G. TARIFF	3
1. <i>Curtailment Tariff</i>	3
2. <i>Cross Connection & Backflow Tariff</i>	3
3. <i>Best Management Practice (“BMP”) Tariff</i>	3

A. INTRODUCTION

On April 22, 2015, Willow Valley Water Co., Inc. ("Willow Valley") and EPCOR Water Arizona Inc. ("EWAZ") filed an application requesting that the Arizona Corporation Commission ("ACC" or "Commission") approve the sale of Willow Valley's utility system and transfer of its Certificate of Convenience and Necessity ("CC&N") to EWAZ.

Willow Valley's ultimate parent company, Global Water Resources, Inc. ("Global"), now seeks to focus on its core service areas in Maricopa and Pinal Counties and on its core business strategy of providing regionally integrated water and wastewater service. As a result, Global has decided to divest Willow Valley's two potable water systems located in Mohave County, well outside its core service area.

EWAZ is an Arizona public service corporation, authorized to provide water service in nine districts in Arizona. Among the water districts operated by EWAZ are the Mohave and North Mohave Water Districts, located approximately ten miles north of Willow Valley's certificated service area. EWAZ currently serves approximately 128,000 water customers throughout Arizona, including approximately 16,000 in its Mohave Water District and 2,000 in its North Mohave Water District. EWAZ has a significant presence in the Mohave County area which should result in economies of scale savings for Willow Valley in the future.

On June 1, 2015, EWAZ filed a supplemental application to seek recovery of approximately \$226,000 through a surcharge mechanism to be approved as part of the sale of Willow Valley's utility system and transfer of its CC&N to EWAZ.

B. WATER SYSTEM

Willow Valley

Willow Valley is an Arizona public service corporation, authorized to provide water utility service in a portion of Mohave County, Arizona under a CC&N granted in Commission Decisions Nos. 32436, 34869, 55434 and 68610. Willow Valley currently serves approximately 1,620 connections in its existing service area of approximately 4.29 square miles. Willow Valley's current water systems consist of 10 wells, with a total capacity of 1,765 gallons per minute ("GPM"); 4 storage tanks, with a combined capacity of 502,000 gallons; 12 booster pump stations; and associated distribution systems. Staff concludes that the system has adequate production and storage capacity to serve existing customers and reasonable growth.

Non-Account Water

Non-account water should be 10 percent or less. It is important to be able to reconcile the difference between water sold and the water produced by the source. A water balance will allow a company to identify water and revenue losses due to leakage, theft and flushing.

Willow Valley reported the following gallons pumped and gallons sold in 2014, which Staff used to determine the water loss per system:

Water Loss

Water System	Gallons Pumped	Gallons Sold	Water loss (%)
King Street, PWS 08-040	76,402,000	53,335,000	30.19
Lake Cimarron, PWS 08-129	8,281,000	7,841,000	5.31*

*Based on the updated 2014 Water Use Data Sheet for the Willow Valley – Lake Cimarron system, provided to Staff on September 18, 2015.

Decision No. 74364 (February 26, 2014) requires that Valencia Water Company – Town Division (“Valencia-Town”), Water Utility of Northern Scottsdale (“WUNS”), Water Utility of Greater Tonopah (“WUGT”), Valencia Water Company - Greater Buckeye Division (“Valencia - Greater Buckeye”), Global Water - Santa Cruz Water Company (“Santa Cruz”) and Willow Valley Water Company (“Willow Valley”) file their water loss report consistent with the Settlement Agreement and the Decision. Accordingly, Global filed its water loss report on May 30, 2014, and May 29, 2015.

Staff recommends that EWAZ prepare a report containing a detailed analysis and plan to reduce water loss to 10 percent or less for Willow Valley water systems. If the EWAZ believes it is not cost effective to reduce the water loss to less than 10 percent, it should submit a detailed cost benefit analysis to support its opinion. In no case shall the EWAZ allow water loss to be greater than 15 percent. The water loss reduction report or the cost benefit analysis shall be docketed as a compliance item within 90 days of the effective date of the order issued in this proceeding if this application is approved.

C. ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY (“ADEQ”) COMPLIANCE

ADEQ reported that Willow Valley water systems have no major deficiencies and are delivering water that meets water quality standards required by 40 CFR 141 (Title 40 Code of Federal Regulations Part 141 National Primary Drinking Water Regulations) and Arizona Administrative Code, Title 18, Chapter 4.¹

E. ARIZONA DEPARTMENT OF WATER RESOURCES (“ADWR”) COMPLIANCE

Willow Valley is not located within an ADWR Active Management Area (“AMA”) and is not subject to any ADWR AMA reporting and conservation requirements. ADWR has determined that Willow

¹ Staff received ADEQ Water Quality Compliance Status Reports dated June 3, 2015.

Valley is currently in compliance with departmental requirements governing water providers and/or community water systems.²

F. ACC COMPLIANCE

A check of the Utilities Division compliance database indicates that there are currently no delinquent compliance items for Willow Valley.³

G. TARIFF

1. *Curtailment Tariff*

Willow Valley has an approved Curtailment tariff on file with the ACC.

2. *Cross Connection & Backflow Tariff*

Willow Valley has an approved Backflow Prevention tariff on file with the ACC.

3. *Best Management Practice ("BMP") Tariff*

Willow Valley also has approved BMP tariffs on file with the Commission.

² Per ADWR Water Provider Compliance Status Reports dated May 7, 2015.

³ Per Compliance Section email dated April 29, 2015.