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**BEFORE THE ARIZONA CORPORATION COMMISSION**

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Commissioner

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AZ CORP COMMISSION  
DOCKET CONTROL

Arizona Corporation Commission  
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OCT 23 2015

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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

**W-01732A-15-0131**  
**W-01303A-15-0131**

**NOTICE OF FILING REBUTTAL  
TESTIMONY**

EPCOR Water Arizona, Inc. files the attached rebuttal testimony of Shawn  
Bradford and Sarah Mahler dated October 23, 2015.

RESPECTFULLY SUBMITTED this 23rd day of October, 2015.

LEWIS ROCA ROTHGERBER, LLP

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ORIGINAL AND thirteen (13) copies  
of the foregoing hand-delivered this  
23rd day of October, 2015, to:

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1 The Arizona Corporation Commission  
2 Utilities Division – Docket Control  
3 1200 W. Washington Street  
4 Phoenix, Arizona 85007

5 Copy of the foregoing hand-delivered  
6 this 23rd day of October, 2015, to:

7 Thomas M. Broderick, Director  
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11 Phoenix, Arizona 85007

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22 Copy of the foregoing mailed  
23 this 23rd day of May, 2015, to:

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Phoenix, AZ 85007



BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

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

**REBUTTAL TESTIMONY  
OF  
SHAWN BRADFORD  
ON BEHALF OF  
EPCOR WATER ARIZONA, INC.  
OCTOBER 23, 2015**

**REBUTTAL TESTIMONY  
OF  
SHAWN BRADFORD  
ON BEHALF OF  
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OCTOBER 23, 2015**

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1 **EXECUTIVE SUMMARY**

2 Mr. Bradford's Rebuttal Testimony supports the Acquisition Adjustment mechanism proposed  
3 by the Company in this proceeding and responds to issues related to acquisition premium that  
4 were raised in the Direct Testimony filed on behalf of the Utilities Division Staff and the  
5 Residential Utility Consumer Office.

1 **I. INTRODUCTION AND QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND TELEPHONE**  
3 **NUMBER.**

4 A. My name is Shawn Bradford. My business address is 2355 W. Pinnacle Peak Road, Suite  
5 300, Phoenix, Arizona 85027, and my business phone is (623) 815-3136.

6 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

7 A. I am employed by EPCOR Water (USA) Inc. ("EWUS"), the owner of EPCOR Water  
8 Arizona, Inc. ("EWAZ" or "Company"), as the Vice President of Corporate Services.

9 **Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES WITH EWUS.**

10 A. My primary responsibilities for EWUS include the management of the Customer Care &  
11 Billing, Public & Governmental Affairs, Information Technology and the Rates &  
12 Regulatory Departments.

13 **Q PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE AND**  
14 **EDUCATION.**

15 A. I have been employed by EWUS since February 1, 2012. Prior to EWUS's acquisition of  
16 the American Water operations in Arizona and New Mexico, I worked for Arizona-  
17 American Water beginning in the fall of 2011.

18 I have over 26 years of experience in the water and wastewater industry, with experience  
19 at all levels, including management, operations, and maintenance. Prior to my current  
20 position with EWUS as the Vice President of Corporate Services, I served as the Director  
21 of Operations for the Central Division of EWAZ and was responsible for over 81,000  
22 water and 45,000 sewer connections in the Sun City, Sun City West, and Agua Fria  
23 Districts.

1 I possess a Master of Business Administration Degree with a focus on Strategic  
2 Leadership from Amberton University as well as a Bachelor of Science Degree in  
3 Management from Becker College and an Associate's Degree in Environmental  
4 Engineering from Northeastern University.

5 **II. PURPOSE OF TESTIMONY**

6 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

7 A. The purpose of my testimony is to respond to recommendations of the Arizona  
8 Corporation Commission Staff ("Staff") to deny recovery of an acquisition premium.

9 **III. STAFF'S RECOMMENDATION TO DENY RECOVERY OF ACQUISITION**  
10 **PREMIUM**

11 **Q. HAVE YOU REVIEWED THE BASIS OF THE STAFF'S AND RUCO'S**  
12 **RECOMMENDATIONS TO DENY RECOVERY OF AN ACQUISITION**  
13 **PREMIUM IN THIS CASE?**

14 A. Yes.

15 **Q. HOW DOES THE COMPANY RESPOND TO THEIR RECOMMENDATIONS?**

16 A. The Company disagrees with the Staff's recommendation to deny recognition of any  
17 acquisition adjustment or other premium to be applied to expenditures required in the  
18 ordinary course of business. The Company has identified additional capital investments  
19 that will improve and enhance the operation of the Willow Valley system in the near term  
20 as well as address water loss concerns. By providing recovery of the purchase price,  
21 which includes a premium, the Commission will support the concept of small system  
22 consolidation and enable the new owner to effectively manage risk by making these  
23 investments to improve the operations of the Willow Valley system.

1 **IV. EWAZ'S ADDITIONAL CAPITAL INVESTMENT PLAN**

2 **Q. PLEASE DESCRIBE THE CAPITAL INVESTMENT PLAN CONTEMPLATED**  
3 **BY THE COMPANY TO ADDRESS EXCESSIVE WATER LOSS IN THE**  
4 **WILLOW VALLEY SYSTEM.**

5 A. EWAZ has identified system-wide needs during our initial due diligence review of the  
6 Willow Valley system. Based on our review to date, we currently estimate a needed  
7 investment of approximately \$1.0 million over the first five years to address existing  
8 water losses and to improve the overall operability of the system. Projects identified to  
9 date include:

- 10 1) Replacement of distribution valves that are currently inoperable,
- 11 2) Maintenance and repairs to the three existing storage tanks,
- 12 3) Redesign of the backwash effluent discharge retention system to prevent leaching  
13 into the aquifer,
- 14 4) Replacement of leaking service lines,
- 15 5) Repair or replacement of failed flow, backwash, and customer meters as well as  
16 other infrastructure projects that may be identified after the transfer of ownership  
17 is completed; and
- 18 6) System interconnect between the King Street and Lake Cimarron areas of the  
19 existing Willow Valley system to provide operational flexibility and redundancy.

20 **Q. WHY SHOULD THE COMPANY'S PROPOSED ACQUISITION ADJUSTMENT**  
21 **BE ADOPTED?**

22 A. EWAZ will need to make significant capital investments to increase the reliability and  
23 quality of the Willow Valley system. The acquisition adjustment described in the

1 testimony of the Company's other witness, Ms. Sarah Mahler, would provide EWAZ the  
2 opportunity to recover the purchase price premium but only if the Company makes the  
3 necessary investments to improve the Willow Valley system.

4 **Q. WHAT ASSURANCES IS THE COMPANY WILLING TO MAKE IF THE**  
5 **COMMISSION SUPPORTS THE ACQUISITION ADJUSTMENT CURRENTLY**  
6 **PROPOSED?**

7 A. If the sale is approved with the requested acquisition adjustment, the Company will  
8 develop and file a Plan of Administration ("POA") within 90 days of the decision. The  
9 POA will include a detailed plan to address non-revenue water, which based on our  
10 understanding is currently at 26%, as well as additional capital improvements not  
11 identified during the Company's initial due diligence review.

12 EWUS has a demonstrated approach to identify and reduce water loss in its existing  
13 systems, and this same approach will be applied in the Willow Valley system. The plan  
14 that is developed will be used to reduce non-revenue water by 25% within the first 5  
15 years of ownership by EWUS and includes the following areas:

- 16 1) Production Meters – the location of all production meters will be verified and  
17 tested to confirm accurate operation.
- 18 2) Customer Meter Replacement Program – a program will be developed to begin  
19 the immediate replacement of all customer meters that are more than 12 years old.
- 20 3) Zero and Low Usage Meter Report – reports will be developed to identify meters  
21 that are currently in service but are registering low or zero usage.
- 22 4) Large meter testing – all meters larger than 2 inches will be tested annually.

- 1           5) Acoustic Leak Detection – existing acoustic leak detection equipment will be
- 2           used to identify system leaks that are not surfacing. Under this program, detected
- 3           leaks are immediately repaired.
- 4           6) Targeted theft prevention – implement a program that is focused on water theft
- 5           from fire hydrants.
- 6           7) Customer Awareness and Reporting Education – routinely distribute educational
- 7           material that allows customers to report any potential or suspected water leaks
- 8           throughout the distribution system.

9   **Q.   WHAT HAPPENS IF THE COMPANY FALLS SHORT OF ITS GOAL TO**  
10 **REDUCE WATER LOSS BY 25% IN THE FIRST FIVE YEARS?**

11 A.   Under the Company's proposal, during a subsequent rate case a surcharge would be  
12 authorized to collect the requested premium. Any surcharge in effect at the end of the  
13 five year period would cease if water loss has not been reduced by 25% and would not  
14 resume until the Company has demonstrated that the system's water loss is declining.

15 **Q.   HOW WOULD THESE IMPROVEMENTS SPECIFICALLY PROVIDE A**  
16 **BENEFIT TO THE EXISTING CUSTOMERS IN WILLOW VALLEY?**

17 A.   As EWAZ's planned capital improvements are completed, customers in Willow Valley  
18 will be provided with much more reliable water service. Examples of the improvements  
19 include:

- 20       1) Replacement of distribution valves will minimize system outages and provide greater
- 21       flexibility when proactive improvements are needed;
- 22       2) As leaks in services lines or water mains are repaired or replaced system wide, water
- 23       loss will be reduced which lowers operating costs;

- 1           3) The storage tanks will be configured to meet peak system demand which will  
2           maintain adequate water pressure at all times; and  
3           4) The planned interconnect between the King Street and Lake Cimarron areas will  
4           provide added operational flexibility and increased reliability of supply that does not  
5           exist today.

6   **Q.    DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

7   **A.    Yes.**

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

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  
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DOCKET NOS: W-01732A-15-0131  
W-01303A-15-0131

**REBUTTAL TESTIMONY  
OF  
SARAH MAHLER  
ON BEHALF OF  
EPCOR WATER ARIZONA, INC.  
OCTOBER 23, 2015**

**REBUTTAL TESTIMONY  
OF  
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1           EXECUTIVE SUMMARY

2 Ms. Mahler's Rebuttal Testimony focuses primarily on the mechanism EWAZ has proposed to  
3 allow it an opportunity to receive a return of the price paid in excess of rate base. Her testimony  
4 also responds to recommendations made in the Direct Testimony filed on behalf of Utilities  
5 Division Staff and the Residential Utility Consumer Office regarding Accumulated Deferred  
6 Income Taxes ("ADIT"), Staff's calculations related to the purchase price, customer security  
7 deposits and EWAZ's capital structure.

1 **I. INTRODUCTION AND QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND TELEPHONE**  
3 **NUMBER.**

4 A. My name is Sarah Mahler. My business address is 2355 W. Pinnacle Peak Road, Suite  
5 300, Phoenix, Arizona 85027, and my business phone is (623) 445-2420.

6 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

7 A. I am employed by EPCOR Water (USA) Inc. ("EWUS"), the owner of EPCOR Water  
8 Arizona, Inc. ("EWAZ" or "Company"), as Manager, Rates.

9 **Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES WITH EWAZ.**

10 A. My primary responsibilities with EWUS are to manage the preparation of rate  
11 applications and other regulatory filings consistent with the applicable regulatory  
12 agency's filing requirements in Arizona and New Mexico. I also assist the Director of  
13 Regulatory & Rates with research and public outreach.

14 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE AND**  
15 **EDUCATION.**

16 A. I have been employed by EWUS since January 2015. I have more than 5 years of  
17 experience in public utility accounting and regulation and another 10 years of experience  
18 managing accounting practices and policies, including expertise in homebuilding,  
19 construction, software and audit/public accounting.

20 I have a Master of Business Administration from the University of Phoenix. I hold  
21 Bachelor of Science degrees from Arizona State University in Accounting and Global  
22 Business with an emphasis on Finance.

1 **II. PURPOSE OF TESTIMONY**

2 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

3 A. EWAZ is seeking to purchase the assets of the Willow Valley water system. My  
4 testimony will focus primarily on the mechanism EWAZ has proposed to allow it an  
5 opportunity to receive a return of its price paid in excess of rate base. My testimony will  
6 also address the Company's response to recommendations by Staff and RUCO regarding  
7 Accumulated Deferred Income Taxes ("ADIT"), Staff's calculations related to the  
8 purchase price, customer security deposits and EWAZ's capital structure.

9 **III. RESPONSE TO STAFF'S AND RUCO'S POLICY ARGUMENTS AGAINST THE**  
10 **PROPOSED ACQUISITION ADJUSTMENT MECHANISM**

11 **Q. STAFF AND RUCO OBJECT TO THE COMPANY'S PROPOSED**  
12 **ACQUISITION ADJUSTMENT MECHANISM, WHY SHOULD IT BE**  
13 **ADOPTED?**

14 A. Staff's objection to the Acquisition Adjustment mechanism is that the projects  
15 themselves warrant no special treatment. Staff argues the projects proposed by the  
16 Company are typically considered part of the utility's routine operating and maintenance  
17 expenses and should be addressed as part of the normal course of utility operations. The  
18 Company has never represented that these investments require special treatment. The  
19 Company believes that the investment needed in Willow Valley to immediately address  
20 existing system wide losses and other critical improvements should be eligible for an  
21 upward adjustment to recover this level of investment in a system that needs  
22 infrastructure.

23 However, the issue to be addressed is whether the Commission should design and adopt a  
24 mechanism to incentivize financially viable and responsible water utilities to invest in

1 challenged systems. The current regulatory environment discourages Class A water  
2 utilities from 1) purchasing systems with significant immediate capital investment  
3 requirements, and 2) paying the fair value determined in an arms-length transaction when  
4 that fair value exceeds the book value of the assets. The Commission should create a  
5 mechanism which allows for an equitable transfer of ownership that benefits both the  
6 community and the utility.

7 RUCO's opposition is based on the erroneous premise that EWAZ is seeking approval of  
8 an acquisition premium to be included in rate base.<sup>1</sup> RUCO references a memorandum  
9 from the Utilities Division dated June 29, 2001, which was not adopted by the  
10 Commission, which details a proposed policy for Class D and E water system  
11 acquisitions. RUCO lists six conditions from that memorandum which Staff identified  
12 must be met in order for an acquisition premium to be approved and included in rate base  
13 of the acquiring company. RUCO also quotes several excerpts from the 1943 Niagara  
14 Falls Power Co. decision in which the inclusion of acquisition premiums in rate base is  
15 detrimental to the customer in two ways:

- 16 1) The seller might persuade the buyer to pay more than the recorded rate  
17 base simply because the difference would be used to increase rates paid by  
18 the public.
- 19 2) Buyers might become indifferent to the purchase price and sellers might  
20 exert more force on the asking price, unwinding the economics of a fairly  
21 assessed, arms-length purchase price.

22 EWAZ has specifically designed the Acquisition Adjustment Mechanism to address  
23 RUCO's concerns by requiring the purchasing company to pay only fair value for an  
24 acquired system. RUCO quotes Professor Bonbright in "Principles of Public Utility  
25 Rates" as stating that the utility shall be "compensated for devoting capital to the public

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<sup>1</sup> The Company's Supplemental filing in this docket defines and uses the term "Acquisition Premium". However, as explained below, the Company's proposed "Acquisition Adjustment Mechanism" is fundamentally different than the acquisition premiums discussed by Staff and RUCO.

1 service.” EWAZ seeks a mechanism to incentivize the purchasing company to do just as  
2 Professor Bonbright states. The proposed Acquisition Adjustment Mechanism  
3 compensates the acquiring company only for investing much needed capital in a system,  
4 where that investment would not otherwise have been made.

5 **Q. WHY IS THE MECHANISM APPROPRIATE IN THIS CASE?**

6 A. There are several reasons discussed below that justify approving a mechanism such as the  
7 one proposed by the Company.

8 (I) Going Concern Value of Willow Valley. The purchase price for the Willow Valley  
9 system reflects the fair market value of the assets and operations being purchased.  
10 The price includes the value of Willow Valley’s CC&N, but exceeds the value of the  
11 property, plant, and equipment (“PPE”) as reflected in the Water Utility Plant  
12 schedules attached to the Willow Valley Water Co., Inc. Annual Report for the year  
13 ending December 31, 2014. In other words, the payment of a premium for Willow  
14 Valley’s PPE over and above the net book value reflects the going concern value of  
15 Willow Valley’s operations (i.e., the net book value of the PPE and the expectation  
16 that Willow Valley will continue to be able to earn a fair return on its investment as  
17 part of the EWAZ water and wastewater utility system) as well as a recognition that  
18 Willow Valley’s assets still in service, but with a net book value of zero, still have  
19 value.

20 (II) Significant investments will be required upon purchase by EWAZ in order to reduce  
21 water loss. EWAZ will need to make significant capital investments to increase the  
22 reliability and quality of the Willow Valley system such as replacement of defective  
23 system valves, installation of a more robust backwash effluent discharge retention  
24 system, and necessary maintenance of storage tanks. EWAZ is willing to implement

1 a five-year capital improvement program, as discussed in Mr. Bradford's testimony,  
2 which would expend approximately \$200,000 annually for the five years following its  
3 acquisition of Willow Valley. The Acquisition Adjustment Mechanism proposed by  
4 the Company will allow EWAZ to earn continuing fair returns following the  
5 acquisition in light of these significant new capital investments.

6 (III) Stay of SIB. Investments that were planned but not completed pursuant to the now-  
7 stayed SIB program should be eligible for the Acquisition Adjustment Mechanism as  
8 well as other necessary projects completed in the five years following the close of the  
9 transaction.

10 (IV) More Reliable Water and Customer Service. As a result of the increased capital  
11 investment, existing Willow Valley customers will receive higher quality and more  
12 reliable water service. In addition, Willow Valley customers served by EWAZ will  
13 receive the same level of service and support as do customers in other EWAZ  
14 districts; service and support that meets or exceeds the service currently provided by  
15 Willow Valley.

16 (V) Fair Value. RUCO's longstanding opposition to any regulatory mechanism has rested  
17 on the absence of a fair value determination. The four variables in the Company's  
18 proposed Acquisition Adjustment Mechanism will be approved in the Commission's  
19 Decision to approve the transfer of assets. However, implementation of the  
20 mechanism will not occur until Willow Valley's next formal rate case. At that time,  
21 Staff and RUCO will have an opportunity to assess the usefulness and value of the  
22 investments made subsequent to the system's transfer of ownership and the  
23 Acquisition Adjustment Mechanism will be implemented at that time. Subsequent  
24 rate filings, up to a test year ended December 31, 2021, will include provisions for

1           recalculation of the Acquisition Adjustment Mechanism. Investments made after  
2           December 31, 2021 will not be eligible for the Acquisition Adjustment Mechanism.

3 **Q.   RUCO'S OPPOSITION TO EWAZ'S REQUEST TO RECOVER THE AMOUNTS**  
4 **IT IS PAYING TO ACQUIRE WILLOW VALLEY IN EXCESS OF RATE BASE**  
5 **IS PREMISED ON THE COMPANY INCLUDING AN ACQUISITION**  
6 **PREMIUM IN RATE BASE. IS EWAZ REQUESTING AN ACQUISITION**  
7 **PREMIUM TO BE INCLUDED IN RATE BASE IN THIS PROCEEDING?**

8 A.   No. The Company is not requesting that an acquisition premium be included in rate base.  
9       Staff and RUCO have misunderstood the Company's request. The Company is going to  
10      pay a premium, but it is not requesting the premium be included in rate base in this case  
11      or any future rate case. Staff and RUCO have confused the proposed Acquisition  
12      Adjustment Mechanism and implied the Company is requesting that a premium be  
13      included in rate base AND that the Company would also receive a premium on  
14      improvements made subsequent to the sale. This is not the case.

15 **Q.   STAFF WITNESS GERALD BECKER STATES THE COMPANY IS**  
16 **PROPOSING AN ACQUISITION PREMIUM AND AN ACQUISITION**  
17 **ADJUSTMENT. WHY IS MR. BECKER MISTAKEN AND EXPLAIN THE**  
18 **DIFFERENCE?**

19 A.   Mr. Becker states that the transfer of Willow Valley from Global to EWAZ does not  
20      warrant payment or regulatory recognition of an acquisition premium. EWAZ strongly  
21      believes that given the condition of the infrastructure and the capital needed to make the  
22      necessary improvements the transfer does warrant payment of an amount in excess of rate  
23      base. EWAZ is not, however, asking for recovery of a return on and of the acquisition  
24      premium for regulatory purposes, but rather only a return of that premium.

1 As with RUCO, Staff's opposition is premised on the mistaken idea that an acquisition  
2 premium would be included in rate base, and the Company would receive a return on the  
3 premium and a return of the premium through an associated amortization.

4 In contrast, the Company's proposal provides a means whereby the Company (or any  
5 acquiring company), through proper stewardship and investment in an acquired system, is  
6 provided the opportunity over a period of years to receive repayment of the original price  
7 paid in excess of rate base.

8 Under the Company's proposal, the Company would simply receive a repayment of the  
9 amount paid in excess of rate base without any consideration for the time value of money  
10 over a period of years or any return on those funds. Those funds, the acquisition  
11 premium, would not be included in rate base.

12 **Q. WHAT IS THE COMPANY REQUESTING?**

13 **A.** EWAZ is asking that the Company be given the opportunity to have the amounts it is  
14 paying to acquire Willow Valley in excess of Willow Valley's rate base returned to it  
15 after the Company has invested a significant amount of capital (currently estimated to be  
16 one million dollars) to address water loss (in excess of 26%) and operational challenges  
17 in the Willow Valley system. The Company is requesting the price paid in excess of rate  
18 base, which will be 10% of rate base or approximately \$200,000, be recovered by EWAZ  
19 over 15 years by adding a small charge currently estimated to be \$1.21 per month to each  
20 Willow Valley customer's bill commencing only after a fair value determination of the  
21 rate base after the investments have been placed in service.

22 **Q. PLEASE EXPLAIN HOW THE RECOVERY OF THE COMPANY'S**  
23 **INVESTMENT WOULD BE IMPLEMENTED.**

1 A. As investments are completed and placed in service, the Company would file a rate case  
2 application that would include these new capital investments and compute an additional  
3 20% premium that would represent the incentive on which to compute a separate revenue  
4 requirement to be recovered over a period of no greater than 15 years.

5 **Q. IS THE COMPANY SEEKING A SEPARATE SURCHARGE TO RECOVER**  
6 **THE 20% PREMIUM?**

7 A. Yes. The revenue requirement effect of the 20% premium will be calculated and  
8 collected via a separate surcharge for a period of 15 years or until the acquisition  
9 premium has been recovered, whichever occurs first.

10 **Q. HAVE YOU PREPARED AN ILLUSTRATION OF THE COMPANY'S**  
11 **PROPOSAL TO COMPUTE THE 20% PREMIUM?**

12 A. Yes. An illustrative example is attached as Exhibit SM-1.

13 **Q. WOULD THE RATE CASE APPLICATION INCLUDE ALL STANDARD**  
14 **FILING REQUIREMENT SCHEDULES?**

15 A. Yes. All standard filing schedules, Schedules A through Schedule H, would be prepared  
16 and submitted for review by the ACC Staff and other interested parties to the case. The  
17 Company would also prepare a cost of capital to determine the appropriate rate of return  
18 to be applied to the Rate Base.

19 **Q. HOW IS THIS CHARGE CALCULATED?**

20 A. There are four variables to the calculation that are discussed below. Illustrative  
21 calculations in support of the Company's proposal are attached as Exhibit SM-1.

22 The first variable is the additional capital that EWAZ identified as potential projects to  
23 invest in the five-year period subsequent to the close of the transaction. At this time, the  
24 potential projects have been estimated at approximately \$1.0 million

1           The second variable is the premium on the estimated \$1.0 million the Company plans to  
2           invest in the first 5 years after the close of the transaction. EWAZ is seeking additional  
3           revenue based on the revenue requirement of a 20 percent premium on the first five years  
4           of capital investment also referred to as an Acquisition Incentive. The Acquisition  
5           Incentive as proposed would be charged to customers for a finite period of time.

6           The third variable is the rate of return. The Company's illustrative calculation in Exhibit  
7           SM-1 uses a 10 percent return on equity ("ROE") to determine the overall cost of capital  
8           (the ROE would be updated in the rate case application discussed above). As illustrated  
9           in Exhibit SM-1, that results in a rate of return (ROR) of 6.74 percent. The actual ROR  
10          to be used for this calculation would be determined in the rate case filing to implement  
11          recovery of the new investment.

12          The first three variables produce a revenue requirement of \$22,107 that the Company  
13          would recover from its customers.

14          The fourth and final variable is the length of time the Company would be allowed to  
15          place a small charge on customer's monthly bills, to recover the Acquisition Incentive  
16          revenue requirement of \$22,107. The Company has proposed a 15 year period, in which  
17          the Company would collect approximately \$331,608 in revenues or \$200,722 in  
18          operating income in its illustrative calculations. As explained below, this amount would  
19          not be included in the calculation of rate base in future rate proceedings.

20   **Q.    WHAT IS THE ACCOUNTING TREATMENT PROPOSED BY THE COMPANY**  
21   **FOR THIS MECHANISM?**

1 A. Upon approval of the transfer of assets to EWAZ, the price paid in excess of rate base  
2 will be recorded to a Regulatory Asset balancing account. This account will NOT be  
3 added to the calculation of rate base for any future rate proceedings as Staff supposes.  
4 EWAZ does not intend to earn a return on the premium paid. The surcharge (as  
5 calculated above) would be collected from customers monthly via their normal cycle  
6 billing. The regulatory asset would be credited monthly and reduce slowly over time (15  
7 years in the Company's proposal). The Company would report this balance to the  
8 Commission on an annual basis. The charge to customers would end upon the earlier of  
9 1) depletion of the regulatory asset or 2) 15 years. See Exhibit SM-2.

10 **IV. RESPONSE TO STAFF AND RUCO REGARDING CREATION OF A**  
11 **REGULATORY LIABILITY FOR ACCUMULATED DEFERRED INCOME**  
12 **TAXES ("ADIT")**

13 **Q. STAFF AND RUCO BOTH RECOMMEND THE CREATION OF A**  
14 **REGULATORY LIABILITY IN RELATION TO GLOBAL'S ADIT BALANCE.**  
15 **HOW DOES THE COMPANY RESPOND?**

16 A. EWAZ is opposed to the creation of a Regulatory Liability on Willow Valley's  
17 regulatory ledgers valued at the updated balance upon close. Staff's is imputing the value  
18 of ADIT and reclassifying the ADIT balance as a regulatory liability. If approved this  
19 action sets in place a policy which will have a negative impact on the consolidation of  
20 small water systems in the State of Arizona, because it may make it more difficult to  
21 reach a satisfactory purchase price. In fact it is not at all certain that the parties to the  
22 asset transfer contemplated by this Application will be able to close the transaction if the  
23 ADIT-associated Regulatory Liability as proposed by Staff and RUCO is included in the  
24 final order. Also, if this policy is adopted by the Commission, consistent treatment of  
25 both ADIT asset balances and liability balances must be utilized.

1 If Staff's recommendation is adopted, however, EWAZ recommends that amortization of  
2 this liability commence immediately upon transfer, at a rate of 14.3% per year for 7  
3 years. This amounts to approximately \$3,175 on December 31, 2014's balance which  
4 will be updated upon close. The 7 year amortization is based upon the Company's  
5 analysis of Global's ADIT balance. The response to Staff's data request number GWB  
6 1.6 demonstrates that Global's net ADIT balance declined from \$367,598 to \$260,224  
7 between December 31, 2011 and December 31, 2014, or \$35,791 per year. Therefore, a 7  
8 year amortization at \$37,175 per year is appropriate.

9 **V. RESPONSE TO STAFF'S CALCULATION OF PURCHASE PRICE AND**  
10 **PREMIUM PAID**

11 **Q. DOES THE COMPANY HAVE ANY ISSUES, BEYOND STAFF'S PROPOSED**  
12 **TREATMENT OF ADIT, WITH STAFF WITNESS GERALD BECKER'S RATE**  
13 **BASE CALCULATIONS?**

14 **A.** Mr. Becker incorrectly subtracts customer security deposits from rate base. Mr.  
15 Becker's calculation on page 8 of his testimony reduces the \$1,964,397 he  
16 calculated by \$31,898 (the amount of customer security deposits held by Willow  
17 Valley) resulting in his erroneously calculated rate base of \$1,932,499. If Mr.  
18 Becker's intent was to reflect the fact that the Company will not be acquiring the  
19 customer security deposits, as provided under the terms of the purchase  
20 agreement, Mr. Becker should have added the \$31,898 instead of subtracting that  
21 amount.

22 **Q. STAFF STATES THERE IS AN UNEXPLAINED DIFFERENCE OF \$11,513 IN**  
23 **THE NET PLANT AMOUNTS PROVIDED BY EWAZ. HOW DO YOU**  
24 **RESPOND?**

1 A. The response to data request number RUCO 2.08, attached as Exhibit SM-3 and  
2 delivered to Staff on June 26, 2015, explains the differences in the net plant for Willow  
3 Valley. The \$11,513 is made up of three components: 1) EWAZ has agreed to purchase  
4 Willow Valley's Construction Work in Progress (CWIP) of \$19,767, which is not  
5 typically included in the calculation of Rate Base, 2) EWAZ has excluded assets with a  
6 net book value of \$8,255 from its purchase, and 3) the net plant includes a correction of  
7 (\$780) to the Accumulated Depreciation balance. The amount of these three previously  
8 explained differences is \$11,512.

9 **Q. WILL GLOBAL FILE A REVISION TO THE ANNUAL REPORT TO THE**  
10 **COMMISSION REFLECTING THE DIFFERENCE IN THE ACCUMULATED**  
11 **DEPRECIATION BALANCE?**

12 A. Yes. EWAZ has asked that Global revise its Annual Report to the Commission to reflect  
13 the correct Accumulated Depreciation balance and they have advised the Company that  
14 they will make that revision.

15 **VI. RESPONSE TO STAFF'S RECOMMENDATION REGARDING**  
16 **CUSTOMER SECURITY DEPOSITS**

17 **Q. STAFF RECOMMENDS THAT EWAZ ASSUME THE CUSTOMER SECURITY**  
18 **DEPOSITS HELD BY WILLOW VALLEY. DOES THE COMPANY AGREE?**

19 A. No, EWAZ does not agree. Mr. Becker's primary concern is the potential for increased  
20 bad debt, which could burden other customers in future rates cases. In EWAZ's Mohave  
21 system, a few miles from the Willow Valley system, bad debt is less than 1% of  
22 revenues. EWAZ does not currently require its customers to pay a security deposit. In  
23 the Willow Valley system, customers are required to pay a security deposit of \$110.  
24 EWAZ's exemplary customer service, advanced website, disconnection policy, and

1 customer education and notification campaigns have made it unnecessary for EWAZ to  
2 implement and manage a costly, time intensive customer security deposit program.  
3 Deposit programs require programming to the billing platform, administration monthly to  
4 assure compliance with ACC rules on water including: deposit interest management,  
5 refunds to customers with 12 on-time payments, recollection after two late payments and  
6 processing refund checks to customers with a credit balance after final billing. These  
7 overhead cost savings will benefit Willow Valley customers under EWAZ ownership.  
8 Willow Valley customers will also be refunded their current security deposit by Global  
9 Water along with applicable interest within 30 days of the transfer of assets to EWAZ.  
10 Willow Valley's balance sheet as of December 31, 2014 listed customer accounts  
11 receivable of \$11,694, customer prepayments of \$28,883, and customer deposits  
12 of \$31,898. This suggests that most Willow Valley customers prefer to prepay  
13 their bill, and should not also be required to submit a security deposit.

14 **VII. RESPONSE TO STAFF'S CONCERNS ABOUT UNBALANCED CAPITAL**  
15 **STRUCTURE**

16 **Q. STAFF HAS RECOMMENDED PLACING EWAZ ON NOTICE THAT IT MUST**  
17 **ATTEMPT TO BALANCE ITS CAPITAL STRUCTURE. HOW DO YOU**  
18 **RESPOND?**

19 A. Staff suggests that EWAZ might attempt to support a 100% equity capital structure upon  
20 presentation of its next rate case involving Willow Valley. Staff's concern appears to be  
21 predicated on treating the Willow Valley system as a stand-alone system and not as a  
22 division of EWAZ. The Willow Valley system will be owned by EWAZ and the  
23 prevailing capital structure of EWAZ at the time of any future rate case will be applied to  
24 Willow Valley.

1 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

2 A. Yes.

**EXHIBIT SM-1**

**EPCOR Water Arizona Inc.  
Simplified Mechanism Demonstration  
Docket No. W-01732A-15-0131  
Docket No. W-01303A-15-0131**

Exhibit SM-1

line	Variable Component of Mechanism	Calculation of Income Requirement *	Acquisition Incentive (20%) **	Total Income Requirement
1	Capital Invested	\$ 1,000,000	\$ 200,000	\$ 1,200,000
2	ROR (10% ROE) EPCOR Water Arizona		6.74%	
3	Income Authorized Per Year (1*2)		\$ 13,480	\$ 80,880
4	Conversion Factor for Taxes		1.64	
5	Revenue Required from customers per year (3*4)		\$ 22,107	\$ 132,643

EXHIBIT SM-2

Exhibit SM-2

EPCOR Water Arizona Inc.  
 Acquisition Adjustment Accounting  
 Docket No. W-01732A-15-0131  
 Docket No. W-01303A-15-0131

	Regulatory Asset	Surcharge per customer per month Number of Customers	Monthly	After 15 Years
Approved Incentive	\$ 200,000		\$ 1,520	\$ 218.16
Year 1 Surcharge	(13,381)			
Balance Year 1	<u>\$ 186,619</u>			
Year 2 Surcharge	(13,381)			
Balance Year 2	<u>\$ 173,237</u>			
	etc.			
		Expected surcharge Gross revenues	\$ 22,107	\$ 331,608
		Bad Debt	\$ 217	\$ 3,250
		Property Tax	\$ 117	\$ 1,758
		Federal Income Tax	\$ 7,065	\$ 105,982
		State Income Tax	\$ 1,326	\$ 19,896
		Operating Income	\$ 13,381	\$ 200,722

Percentage of revenues \*

0.98%  
 0.53%  
 31.96%  
 6.00%  
 60.53%

Accounting entry generated from Billing System would resemble the following:

DR Customer Accounts Receivable	\$ 22,107
CR Bad Debt	\$ 217
CR Property Tax	\$ 117
CR Federal Income Tax	\$ 7,065
CR State Income Tax	\$ 1,326
CR Regulatory Asset	\$ 13,381

\* These percentages were taken from the Mohave Water Districts pending case, Docket No. WS-01303A-14-0010. The Mohave district is the district currently operated by EWAZ that most closely resembles the Willow Valley district, in our opinion.

EXHIBIT SM-3

**COMPANY:** EPCOR Water Arizona Inc. and Willow Valley Water Co., Inc.  
**DOCKET NO:** WS-01303A-15-0131 and W-01732A-15-0131

**Response provided by:** Mike Liebman (Part 1)  
**Title:** CFO, Global Water Resources, Inc.

**Address:** 21410 N. 19<sup>th</sup> Ave., Suite 220  
Phoenix, Arizona 85027

**Response provided by:** Greg Barber and Sarah Mahler (Part 2)  
**Title:** Controller and Manager, Rates & Regulatory

**Address:** 2355 W. Pinnacle Peak Road, Suite 300  
Phoenix, AZ 85027

**Company Response Number:** RUCO 2.08

Page 1 of 2

**Q:** Utility Plant in Service ("UPIS") – Please reconcile the following two UPIS amounts identified on the following two pages in the Original and Supplement to the Application below:

1. **Original Application** - Exhibit B on page 4 at the bottom line (Line not numbered) in the amount of \$2,785,645; and
2. **Supplement to Application** – Net Utility Plant in Service amount of \$2,796,377 on page 4 at line 6.

Please identify the source of the discrepancy between the amounts in 1 and 2 above, which is a difference of \$10,732. In addition, please provide the supporting accounting documentation that reconciles the difference.

- A:**
1. The \$10,732 discrepancy between Original Application (Exhibit B, Page 4) and the Supplement to Application is due to the following (see schedule below):
    - a) \$19,767 of Construction Work in Process is not included in Plant in Service in the Original Application, but is included in Supplement to Application as EPCOR is paying value for this asset.
    - b) (\$8,255) of miscellaneous assets, including computer hardware/software and office furniture, Global Water and EWAZ agreed to exclude from the Purchase Price.
    - c) (\$780) of accumulated depreciation variance between Original Application and the Annual Report.

**COMPANY:** EPCOR Water Arizona Inc. and Willow Valley Water Co., Inc.  
**DOCKET NO:** WS-01303A-15-0131 and W-01732A-15-0131

**Response provided by:** Mike Liebman (Part 1)  
**Title:** CFO, Global Water Resources, Inc.

**Address:** 21410 N. 19<sup>th</sup> Ave., Suite 220  
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Phoenix, AZ 85027

**Company Response Number:** RUCO 2.08

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**Bridge from Original Application (Exhibit B Page 4) to Supplement to Application**

Net PP&E per Original Application (Exhibit B Page 4)	\$2,785,645
Add: Construction Work in Process (CWIP)	\$19,767
Subtract: Miscellaneous assets excluded from purchase price	\$(8,256)
Subtract: Accumulated depreciation variance	\$(780)
<b>Net PP&amp;E per Supplement to Application</b>	<b>\$2,796,377</b>

2. Please reference the table below for a reconciliation of the 2014 Willow Valley Annual report (Exhibit B, p. 4) and the final acquisition value contained in the Supplement to Application. During the due diligence process, the parties agreed to exclude certain assets from the Purchase Price. The amount of those assets can be found in the attachment to this response labeled "Assets Reconciliation.xls". The table copied below is also in that file.

Description	Willow Annual Report (Exh. B P 4.)	Accumulated Depreciation Difference	Total Adjusted Plant	Excluded Assets	CWP	Final Plant Plant Value
Original Cost	\$ 5,168,988	\$ -	\$ 5,168,988	\$ (22,879)	\$ 19,767	\$ 5,165,876
Accumulated Depreciation	\$ (2,383,343)	\$ (780)	\$ (2,384,123)	\$ 14,624		\$ (2,369,499)
Net UPIS	\$ 2,785,645	\$ (780)	\$ 2,784,865	\$ (8,255)	\$ 19,767	\$ 2,796,377