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BEFORE THE ARIZONA CORPORATION COMMISSION

EXCEPTION

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11 IN THE MATTER OF THE JOINT

12 APPLICATION OF WILLOW VALLEY

13 WATER CO., INC. AND EPCOR WATER

14 ARIZONA, INC. FOR APPROVAL OF THE

15 SALE OF ASSETS AND TRANSFER OF

16 CERTIFICATE OF CONVENIENCE AND

17 NECESSITY.

Docket No. W-01732A-15-0131

Docket No. W-01303A-15-0131

Arizona Corporation Commission

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RUCO'S EXCEPTIONS

18 The RESIDENTIAL UTILITY CONSUMER OFFICE ("RUCO") hereby files its Exceptions

19 to the Recommended Opinion and Order ("ROO") in the matter of WILLOW VALLEY WATER

20 CO. AND EPCOR WATER ARIZONA, INC.'s ("Applicants") application for approval of the sale

21 of assets and transfer of Certificate of Convenience and Necessity.

22 RUCO takes exception to the ROO's recommendation to decline to create a regulatory

23 liability or other remedy in the amount of Willow Valley's current Accumulated Deferred Income

24 Taxes ("ADIT") balance. However, rather than object to the transfer based on the ADIT issue

alone, RUCO requests the Commission defer ruling on this issue until the Company's next rate

case similar to the ROO's recommendation on the issue of the acquisition premium. At that

point the Commission will have a better idea of what the quantifiable benefits of the transaction

are and will be in a better position to do what is fair regarding the ADIT issue. RUCO's

1 proposal is a fair and reasonable way to address a clear inequity that will result from a transfer
2 of assets between two well qualified utilities which will serve only to raise the ratepayer's rates.

3 **THE PROPOSED TRANSFER WILL RESULT IN HIGHER RATES BECAUSE**
4 **RATEPAYERS WILL LOSE A SUBSTANTIAL CREDIT FOR INCOME TAXES ALREADY**
5 **PAID**

6 The issue of ADIT has to do with the timing difference between what is recorded on the
7 Company's Books as depreciation expense and what the Company records for tax purposes.
8 The net total of the income taxes paid by Willow's customers which will have been deferred but
9 not paid to the IRS prior to the transfer is \$260,224. In the absence of the transfer these
10 accumulated and deferred taxes would be credited to Willow's ratepayers through an offset to
11 Willow's ratebase – which translates to lower rates.

12 The ratebase that will be transferred, however, under the Application will not include the
13 ADIT offset. The deferred ADIT balances will remain with the seller. This inherent inequity is
14 the result of the manner in which the Applicants set up the transfer – in other words, whether
15 intentional or not the effect of the way this transfer is organized is Willow's customers will not
16 get credit for the income taxes paid. For this reason alone, the transfer is not in the public
17 interest.

18 Both Staff¹ and RUCO have attempted to address this gross inequity by the creation of a
19 regulatory liability whose purpose would be to offset the inequity. The ROO rejects the
20 regulatory liability recommendation, or any credit for that matter for several reasons. First, the
21 ROO finds that there is no longer an ADIT balance to recognize. After the transfer it is true the
22 ADIT balance will no longer exist. But what will exist is the fact that the Company's customers

23 _____
24 ¹ Staff in its surrebuttal case withdrew its recommendation to create a regulatory liability. S-6 at 3. Staff provided no alternative to address the inequity. Id.

1 will still have paid \$260,224 in income tax that they would have been credited for had the
2 transfer not taken place. Why should the customers not be credited for the income taxes that
3 they paid to support a transaction between two well qualified utilities which will not provide
4 them any quantifiable benefits to make up for the loss? Second, the ROO finds that it is highly
5 likely that requiring Willow Valley to carry an ADIT balance that no longer exists on its books
6 would likely violate the IRS normalization rules. While the Company, Staff and the ROO claim
7 that it is a concern, there is no guarantee, as even Staff admits, that the establishment of a
8 regulatory liability will violate the IRS' normalization rules. At this point nobody knows how the
9 IRS would treat a regulatory liability.

10 RUCO does understand the concern raised. The answer, however, is not to simply
11 disregard it as the ROO recommends. The only way to definitively know how the IRS would
12 treat the regulatory liability for tax purposes is to request a private letter ruling ("PLR") from the
13 IRS. Ralph Smith, arguably the only expert qualified in this matter to address this issue, noted
14 at the hearing that a PLR made before transaction approval, and based specifically on the facts
15 presented in this case would be one way that the normalization concerns raised could be fully
16 vetted. There was no PLR done in this case nor is there one pending. While it may be costly,
17 time consuming and otherwise a pain, if the Applicants insist on moving forward with the
18 Application structured in its current fashion, a PLR should be required. To simply overlook or
19 dispatch with it as the ROO suggests, is not in the public interest.

20 The concern with a potential IRS violation would be a ruling prohibiting the Company
21 from using accelerated depreciation for tax purposes – which RUCO agrees would be counter
22 to the ratepayer's interests. But RUCO's witness, Mr. Ralph Smith testified that he is not
23 aware of any instance where the IRS has denied a Company the use of accelerated
24

1 depreciation. Mr. Smith further indicated that the IRS typically allows companies that cross
2 the line in situations where there is not clarity an opportunity to remedy the problem.

3 The ROO also rejects RUCO's recommendation to require the Applicants to restructure
4 the proposed transaction as a stock transaction to preserve the ADIT balance. The simple
5 truth is that Willow's ratepayers would not be harmed by the extinguishment of ADIT had the
6 Applicants structured it this way or if there is no transfer. The fact that the Applicants did not
7 structure it differently and will not now consider it is very telling. In the recent FORTIS
8 acquisition of Unisource Energy Corporation, the transaction was structured as a stock transfer
9 thus avoiding the harm to the ratepayer from the extinguishment of the utilities ADIT. Approving
10 this transaction as proposed in the ROO will send a clear message to Company's considering
11 the sale of their assets to structure it in a way that harms the customers

12 The ROO attempts to address the harm cause by the sale by noting that any harm will
13 be offset by the more favorable capital structure that will result from the transfer. The ROO
14 oversteps here because there is no testimony in the record that establishes an improved
15 capital structure resulting from the sale or a beneficial capital structure which equates to the
16 ADIT loss. When asked about this very issue, EPCOR said it would be "premature" to
17 speculate potential changes to Willow's capital structure prior to its next rate case. Staff
18 explained that the numbers are only conjecture at this time.

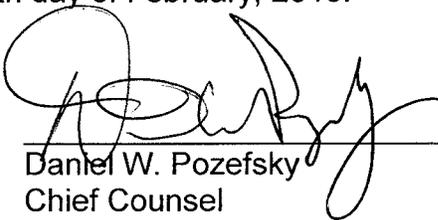
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20 **THE COMMISSION SHOULD DECIDE THE ADIT ISSUE IN THE COMPANY'S NEXT**
21 **RATE CASE**

22 The ROO throws the towel in on this issue at the significant expense of the ratepayer.
23 Again, why should the ratepayer lose credit for taxes paid in an asset transfer between two well
24 qualified utilities with no quantifiable benefits to the ratepayer? Why should the Commission by

1 approving the ROO, establish a bad precedent which encourages asset transfers be set-up in
2 a manner that harms the ratepayers when the Companies can just as easy set it up in a less
3 harmful way?

4 The ROO recommends the Commission wait until the Company's next rate case to
5 determine the issue of the acquisition premium. Staff's witness, in his direct testimony included
6 the ADIT loss in Staff's calculation of the total acquisition premium. RUCO also sees it as part
7 of the acquisition premium – in the next rate case the benefits will be clear and quantifiable,
8 including the Company's capital structure. The Commission can then see if it is fair and
9 reasonable to deny ratepayer's credit for their loss of income taxes paid – because it surely is
10 not fair and/or reasonable to deny the ratepayer credit at this time.

11 RESPECTFULLY SUBMITTED this 25th day of February, 2016.

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13 
14 Daniel W. Pozefsky
Chief Counsel

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19 AN ORIGINAL AND THIRTEEN COPIES
20 of the foregoing filed this 25th day
of February, 2016 with:

21 Docket Control
22 Arizona Corporation Commission
1200 West Washington
23 Phoenix, Arizona 85007
24

1 COPIES of the foregoing hand delivered/
mailed/mailed this 25th day of February, 2016 to:

2
3 Scott Hesla
4 Hearing Division
5 Arizona Corporation Commission
6 1200 W. Washington
7 Phoenix, Arizona 85007

8
9 Robin Mitchell
10 Legal Division
11 Arizona Corporation Commission
12 1200 W. Washington
13 Phoenix, Arizona

14
15 Thomas Broderick
16 Utilities Division
17 Arizona Corporation Commission
18 1200 W. Washington
19 Phoenix, Arizona 85007

20
21 Thomas Campbell
22 Stanley B. Lutz
23 Lewis Roca Rothgerber, LLP
24 201 E. Washington
Phoenix, Arizona 85004
Attorneys for EPCOR Water Arizona, Inc.

25
26 Timothy Sabo
27 Snell & Wilmer
28 One Arizona Center
29 400 E. Van Buren, Suite 1900
30 Phoenix, Arizona 85004
31 Attorneys for Willow Valley Water Co.,
32 Inc.

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RUCO'S PROPOSED AMENDMENT #1
ADIT

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PAGE 16, LINES 21-24

Under the circumstances, we believe it is reasonable and appropriate to defer consideration of recovery of the Acquisition Premium through the proposed AAM until Willow Valley's next rate case. In light of the foregoing, we decline to adopt the recommendations of Staff and RUCO to deny recovery of the Acquisition Premium at this time.

INSERT

PAGE 16, LINES 21-24

Under the circumstances, we believe it is reasonable and appropriate to defer consideration of recovery of the Acquisition Premium through the proposed AAM until Willow Valley's next rate case. In light of the foregoing, we decline to adopt the recommendations of Staff and RUCO to deny recovery of the Acquisition Premium at this time. We further defer consideration of the ADIT balance until Willow Valley's next rate case when a more comprehensive analysis of the benefits of this transaction can be made and ascertained.

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PAGE 16, LINE 25 – PAGE 17 LINE 12

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Page 18 Lines 9-11

IT IS FURTHER ORDERED that, as discussed herein, consideration of the proposed Acquisition Adjustment Mechanism shall be deferred to Willow Valley Water Co., Inc.'s next general rate case.

INSERT

Page 18 Lines 9-11

IT IS FURTHER ORDERED that, as discussed herein, consideration of the proposed Acquisition Adjustment Mechanism and the ADIT balance shall be deferred to Willow Valley Water Co., Inc.'s next general rate case.