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ORIGINAL

EXCEPTION

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BEFORE THE ARIZONA CORPORATION COMMISSION

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DOUG LITTLE
Chairman

BOB STUMP
Commissioner

BOB BURNS
Commissioner

TOM FORESE
Commissioner

ANDY TOBIN
Commissioner

AZ CORP COMMISSION
DOCKET CONTROL

Arizona Corporation Commission

DOCKETED

FEB 25 2016

DOCKETED BY *[Signature]*

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

EPCOR WATER ARIZONA,
INC.'S EXCEPTIONS

EPCOR Water Arizona Inc. ("EWAZ" or "Company") respectfully submits the following Exceptions to the Recommended Opinion and Order ("ROO") issued on February 16, 2016 in this matter. EWAZ appreciates the ROO's approval of the proposed transaction, its analysis of EWAZ's proposed Acquisition Adjustment Mechanism and the general support for such a mechanism. EWAZ urges, however, that the ROO be strengthened to make clear that, consistent with its long stated policy of encouraging the acquisition of small or troubled, privately-held water companies by larger companies able and willing to commit the resources necessary to acquire and provide service, the Arizona Corporation Commission ("Commission") approves of the Acquisition Adjustment Mechanism proposed by EWAZ in this matter and authorizes EWAZ to utilize that

201 E Washington Street Suite 1200
Phoenix, Arizona 85004-4429

Lewis Roca
ROTHGERBER CHRISTIE

1 mechanism to seek recovery of the acquisition premium it will pay to acquire the Willow
2 Valley system as part of its next rate case for that system.

3 As currently written, the ROO allows EWAZ to seek approval of an acquisition
4 adjustment in its next rate case, based upon a showing of discernible benefits, but does not
5 specifically authorize EWAZ to utilize the Acquisition Adjustment Mechanism proposed
6 in this case. EWAZ believes that the ROO should make clear that the Commission (1)
7 actively supports the acquisition of smaller or troubled water companies by larger
8 companies committed to continued operations in Arizona, (2) has authorized use of the
9 Acquisition Adjustment Mechanism proposed by EWAZ to incentivize such acquisitions
10 while maintaining protections for ratepayers, and (3) approves of recovery of the
11 "Acquisition Premium," subject to Commission approval of the specifics of such recovery
12 in the context of a full future rate case proceeding.

13 As a policy matter, the Commission has consistently encouraged the acquisition of
14 small or troubled, privately-owned water companies by larger companies willing and
15 committed to providing quality service to ratepayers. Unfortunately, current practice
16 before the Commission provides significant disincentives to such acquisitions. Until the
17 Commission recognizes that the funds spent on acquisition premiums are "an essential or
18 desirable part of an integration of facilities program", [Direct Testimony of J. Michlik, Att.
19 E at p. 4-11], that is unlikely to change.

20 To address the disincentives created by current practices, EWAZ has proposed a
21 template that provides a path forward for companies, including in this instance, EWAZ, to
22 acquire a small or troubled water company with demonstrated needs for capital
23 improvements and to invest in needed infrastructure at heightened levels. The proposed
24 mechanism does so by (1) recognizing that the value of a utility, even a small, troubled
25 utility, often exceeds the net book value of its assets shown in Commission annual reports;
26 and (2) requiring an acquiring company to make substantial, verifiable investments that

1 provide quantifiable benefits to the customers in the acquired system that address whatever
2 issues that system may have (i.e., water quality, reliability, or in this case, water loss, etc.).
3 Once those additional capital investments have been made, the acquiring company would
4 be allowed to seek recovery of some portion of the amount it is paying in excess of net
5 book value in a future rate proceeding. Recovery of that acquisition premium would be
6 through a small surcharge placed on customers' monthly bills calculated on the amount of
7 the additional capital infusion made by the acquiring company to address system issues,
8 the recovery percentage authorized by the Commission, the timeframe authorized for
9 recovery, and the rate of return set by the Commission. To allow the Commission to
10 directly address the issues facing any water system being acquired, recovery under the
11 mechanism is expressly contingent upon the establishment of a quantifiable metric that
12 must be met in order for a company to continue to recover the surcharge—here, that metric
13 is a measurable reduction in water loss.

14 Under the Company's proposal, the Company would need to commit to increased
15 investment in the Willow Valley system to address water loss issues over the next five year
16 period. As such investments are completed and placed in service, the Company would file
17 a rate case application that would seek to include these new capital investments in rate
18 base. To recover a portion of the Acquisition Premium, the Commission is asked to
19 authorize a 20 percent premium on that investment. That premium would be used solely to
20 calculate a separate revenue requirement to be recovered through a surcharge over a period
21 not to exceed 15 years (or until the Acquisition Premium has been recovered, whichever
22 occurs first).¹

23 The template proposed by the Company is a carefully tailored mechanism that the
24 Commission could use to alter current disincentives to future acquisitions by authorizing
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¹ A chart illustrating the Acquisition Adjustment Mechanism is attached as Exhibit A.

1 recovery of some portion of the acquisition premiums paid by acquiring companies, while
2 insuring that rate payers are adequately protected.

3 EWAZ has provided proposed language for amended Finding of Fact Nos. 5 and 7
4 and the second Ordering paragraph consistent with these Exceptions on the attached
5 Exhibit B.

6
7 RESPECTFULLY SUBMITTED this 25th day of February, 2016.

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9 LEWIS ROCA ROTHGERBER CHRISTIE, LLP

10 

11 _____
12 Thomas H. Campbell
13 Stanley B. Lutz
14 201 E. Washington Street
15 Phoenix, AZ 85004
16 (602) 262-5704
17 Attorneys for EPCOR Water Arizona Inc.

18 ORIGINAL AND thirteen (13) copies
19 of the foregoing hand-delivered this
20 25th day of February, 2016, to:

21 The Arizona Corporation Commission
22 Utilities Division – Docket Control
23 1200 W. Washington Street
24 Phoenix, Arizona 85007

25 Copy of the foregoing hand-delivered
26 this 25th day of February, 2016, to:

Thomas Broderick
Director, Utilities Division
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Dwight Nodes
Chief Administrative Law Judge, Hearing Division
1200 W. Washington Street
Phoenix, Arizona 85007

201 E Washington Street Suite 1200
Phoenix, Arizona 85004-4429

Lewis Roca
ROTHGERBER CHRISTIE

1 Janice Alward
2 Chief Counsel, Legal Division
3 Arizona Corporation Commission
4 1200 W. Washington Street
5 Phoenix, Arizona 85007

6 Copy of the foregoing mailed/emailed
7 this 25th day of February, 2016, to:

8 Timothy Sabo
9 Snell & Wilmer
10 400 E. Van Buren, Suite 800
11 One Arizona Center
12 Phoenix, Arizona 85004

13 Daniel W. Pozefsky
14 Chief Counsel
15 Residential Utility Consumer Office
16 1110 W. Washington St. Suite 220
17 Phoenix, AZ 85007

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Jayne Williams

EXHIBIT A

**Acquisition Adjustment Mechanism
Illustrative Recovery Scenario**

Rate Base Value (est.)	\$2,000,000
Acquisition Premium (10%)	\$200,000
Total Purchase Price	\$2,200,000
5-Year Capital Investment (est.)	\$1,000,000
Annual Revenue Requirement on Investment	\$110,500
Capital Investment Premium (20% of \$1M)	\$200,000
Annual Revenue Requirement	\$ 22,100
Capital Investment Premium Surcharge	\$1.21/month

EXHIBIT B

DELETE: Finding of Fact No. 5, p. 16, ll. 5—8

INSERT: p. 16, ll. 5

5. The Commission seeks to incentivize the consolidation of private water utilities in Arizona. The AAM proposed by EWAZ is one method that the Commission recognizes is appropriate to incentivize the acquisition of small or troubled, private water utilities in Arizona.

DELETE: Finding of Fact No. 7, p. 16, ll. 15—24

INSERT: p. 16, ll. 15

7. At this time, the Commission is unable to adequately determine whether the proposed transaction will provide clear, quantifiable and substantial net benefits to ratepayers. Such a determination must await Willow Valley's next rate case. However, we authorize EWAZ to seek recovery of the Acquisition Premium in Willow Valley's next filed rate case utilizing the AAM proposed by EWAZ. Any such recovery should be based on 20 percent of any capital invested to reduce water loss in the Willow Valley system. The Commission will consider, in the context of Willow Valley's next full rate case, the specific rate making factors applicable to any recovery under the AAM.

DELETE: Page 18, ll. 9-11

INSERT:

IT IS FURTHER ORDERED that, as discussed herein, EWAZ is authorized to seek recovery of the Acquisition Premium in Willow Valley's next filed rate case utilizing the Acquisition Adjustment Mechanism as described above. Consideration of specific rate making factors applicable to any such authorized recovery shall be deferred until that rate case.