1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 KRISTIN K. MAYES
CHAIRMAN
3 GARY PIERCE
COMMISSIONER
4 SANDRA D. KENNEDY
COMMISSIONER
5 PAUL NEWMAN
COMMISSIONER
6 BOB STUMP
COMMISSIONER
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IN THE MATTER OF THE APPLICATION OF GLOBAL WATER – PALO VERDE UTILITIES COMPANY FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERY THROUGHOUT THE STATE OF ARIZONA.	Docket No. SW-20445A-09-0077
IN THE MATTER OF THE APPLICATION OF VALENCIA WATER COMPANY – GREATER BUCKEYE DIVISION FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERY THROUGHOUT THE STATE OF ARIZONA.	Docket No. W-02451A-09-0078
IN THE MATTER OF THE APPLICATION OF WILLOW VALLEY WATER COMPANY FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERY THROUGHOUT THE STATE OF ARIZONA.	Docket No. W-01732A-09-0079
IN THE MATTER OF THE APPLICATION OF GLOBAL WATER – SANTA CRUZ WATER COMPANY FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERY THROUGHOUT THE STATE OF ARIZONA.	Docket No. W-20446A-09-0080

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IN THE MATTER OF THE APPLICATION OF WATER UTILITY OF GREATER TONOPAH FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERY THROUGHOUT THE STATE OF ARIZONA.	Docket No. W-02450A-09-0081
IN THE MATTER OF THE APPLICATION OF VALENCIA WATER COMPANY – TOWN DIVISION FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES FOR UTILITY SERVICE DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERY THROUGHOUT THE STATE OF ARIZONA.	Docket No. W-01212A-09-0082

RUCO'S CLOSING BRIEF

INTRODUCTION

The Residential Utility Consumer Office ("RUCO") submits this Brief in response to Global Water's ("Global Water," "Global," "Global Utilities," or "Company") request that the Arizona Corporation Commission ("Commission") authorize a rate increase for the Company's Palo Verde Water Company ("PVWC"); Valencia Water Company ("VWC") (Valencia-Town and Valencia-Buckeye); Willow Valley Water Company ("WVWC"); Santa Cruz Water Company ("SCWC") and Greater Tonopah Districts ("WUGT").

Total Water Management ("TWM") – Global's visionary approach to managing scarce water resources in high-growth areas is a wonderful idea and truly deserves attention. A-7 at 20[1]. However, its implementation should not come at a cost that is unfair to the Company's ratepayers. From the Company's perspective, this case is about TWM, and not about "… rate

[1] For ease of reference, trial exhibits will be identified similar to their identification in the Transcript of Proceedings. The Transcript volume number and page number will identify references to the Transcript.

base, expenses, and rate of return." A-8 at 2. Nonetheless, to achieve TWM, the Company is asking the Commission to approve accounting gimmicks which result in nothing more than substantially higher rates for ratepayers. Specifically, to achieve TWM, the Company is asking the Commission, for ratemaking purposes, to turn a blind eye to the financial impact on Global Utilities from the proceeds of Infrastructure Coordination and Financing Agreements ("ICFA") entered into between Global's parent company ("Global Parent") and landowners. The Company's proposed accounting treatment of the ICFA proceeds (or lack of accounting treatment) is really a transparent attempt by the utility and its parent to avoid the effect on Global's ratebase that normally occurs when a utility receives Contributions In Aid Of Construction ("CIAC") – i.e. a reduction to the ratebase. A reduction in ratebase translates to lower rate for ratepayers.

From the onset, it should be pointed out that most of what Global claims are issues that face the water industry in Arizona that RUCO agrees with. RUCO is not critical of the Company's claims regarding the scarcity of water in Arizona and the need for the Commission to address these concerns. RUCO is critical of the accounting treatment that the Company proposes as a solution. The Company has not shown that the proposed solutions cannot nor should not be addressed by normal regulatory accounting. Rather, the Company goes on a rant against traditional ratemaking and claims that CIAC is the root of all evil – it "destroys utility companies." A-8 at 13. In fact, as the evidence shows, and will be developed further in this Brief, CIAC has benefits for the ratepayer, shareholder and the utility as well.

THE COMMISSION SHOULD TREAT THE PROCEEDS FROM THE ICFAS AS CIAC AND APPROVE A CORRESPONDING REDUCTION TO GLOBAL'S RATEBASE

ICFA's are voluntary agreements entered into between Global Parent and landowner's to coordinate the planning, financing and construction of off-site water and wastewater plants. A-7 at 31. During the time period of 2004 through 2008 Global Parent collected $60,084,123.00 in ICFA proceeds. Id. at 32. During that same period Global Parent spent $83,080,153.00 on acquisitions and consolidations. Id. According to the Company, none of the ICFA proceeds were used to pay for Global's plant. S-10 at 6.

Global Parent accounts for the ICFA fees as deferred revenues until such time as capacity is met at which time the ICFA fees are converted into operating revenue. S-10 at 8. While it has not been established with any degree of certainty what the proceeds from the ICFA were used for, RUCO agrees with Staff's conclusion that the ICFA fees are an integral part of Global's financing of plant used to supply utility service. Id. at 12, R-7 at 8. The Company's proposal, if approved has the effect of keeping what would otherwise be considered CIAC in Global's ratebase. R-7 at 8. The normal ratemaking treatment of CIAC is to treat it as a reduction to ratebase which results in lower rates.

As Staff noted, Global Utilities derives all of its external financing other than contributions, advances and WIFA debt, from Global Parent through Global Parents' investment of equity. S-10 at 11. The equity investment was derived from Global Parents' net income, which was largely derived from the ICFA fees. Id. It is not reasonable to assume that Global Parent could collect the ICFA fees absent its relationship to its utilities. Id. at 12. The nature of the ICFA allows for the collection of the fees only in instances where a developer or landowner needs plant for utility service. Id. In short, there is a clear

connection between the ICFA fees and the utility's plant financing which should not be dismissed as the Company proposes.

In fact, from the evidence in the record, it appears that Global Parents use of the ICFA's was contemplated for the purpose of avoiding reductions to its utilities ratebase. This conclusion is supported by the minimal amount of plant paid for by contributions for each of the utility divisions. Id. Global Parent received over $60 million in ICFA fees, yet Global constructed plant normally paid for by developers. Id. The Commission should not be persuaded by the Company's argument that there is no accounting relationship between the ICFA's and Global's plant.

The lack of contributions to pay for Global's plant should come as no surprise given Global's disdain for CIAC. According to Global Utilities' President, Trevor Hill "CIAC destroys utility companies." A-8 at 13. Mr. Hill notes that this is the reason why there is very little CIAC on Global's books. Id. But in truth, CIAC benefits both the ratepayer and the utility in many ways and it is shortsighted to dismiss the importance of CIAC as a ratemaking tool.

As regards CIAC, traditional ratemaking practices have been established to insure that utilities do not earn a recovery on and a recovery of capital that is provided by third parties as opposed to utility investors. R-7 at 7. This same ratemaking practice also shifts the risk away from both utilities and their captive ratepayers back to the developer. Id. Typically, a utility earns a rate of return on utility plant in service that has been financed either by capital provided by the issuance of either equity or debt. Id. In addition to receiving a return on this invested capital (i.e. operating income), utilities are also permitted a dollar-for-dollar recovery of it through annual depreciation expense. Id. Both the recovery on and the recovery of investor supplied capital is embedded in the rates that are paid by the utility's customers. Id. at 7-8.

In the case of ICFA's, the utility obtains the capital from third parties (typically developers) and not the utilities' investors to construct the plant needed to serve their development projects. Id. at 8. Ordinarily, if the developer provides the capital with no repayment plan, such as the case with ICFA's, it is booked as CIAC and subsequently treated as a deduction from rate base to offset the utility plant that it financed (the same treatment applies to plant built by a third party and contributed to the utility). Id. By deducting the CIAC from the utility plant that it financed, the utility does not earn a return on it that would be recovered in rates. Id. Because CIAC is amortized over time there is no recovery of the contributed plant through depreciation expense because of accounting entries that offset the amount of depreciation expense associated with the contributed plant. Id. This standard ratemaking procedure insures that utilities do not recover funds that were not provided by its investors through the rates that are paid by captive customers. Id. It also shifts the risk away from the utility and ratepayer back to the developer.

The risk remains with the developer because if the development never materializes it is the developer and not the utility or the ratepayer who is out of the money. In other words, the standard ratemaking treatment guarantees that current ratepayers do not end up paying for plant intended to serve future ratepayers that do not exist or have left the system. Id. at 9. CIAC solves this problem by shifting the risk associated with the new construction of plant for new development away from the utility and the ratepayers and placing it with the third party developer who must put his or her own funds at risk. Id.

Global has creatively avoided this traditional regulatory scheme and proposes a procedure which would greatly advantage its shareholders and deny the ratepayers the benefits and protections associated with traditional ratemaking. As explained above, Global Parent infuses the funds received from the ICFA's into its operating utilities as equity capital

as opposed to CIAC. Id. In this manner, Global Utilities earns a return on and a return of capital that was supplied by a third party developer through the rates paid by its captive customers who are now exposed to the risk of having to pay for plant that is intended for customers who may never materialize or have left the system. Id.

Mr. Hill's argument that CIAC creates poor infrastructure and weak undercapitalized utilities is not applicable where utility managers use a reasonable mix of debt, equity and third party zero-cost capital (such as CIAC and AIAC) to finance utility plant. Id. at 9. A proper and balanced mix of financing is something that has been accomplished by successful utilities in Arizona without the need for ICFA's. Id. An overreliance on CIAC, or debt and equity for that matter is never a good utility strategy, as it deprives ratepayers of accounting treatments which result in lower rates. The end result of lopsided financing methods is typically unfair and unreasonable rates.

The Company could have mitigated and possibly eliminated the opposition it is facing now had it sought approval earlier from the Commission for the ratemaking treatment it proposes. Like every other business decision, when a company decides to buy a weak or distressed utility, the company needs to do a complete financial analysis that includes the ratemaking treatment that the Commission generally allows for developer contributed capital. Id. at 11. If the traditional ratemaking treatment is to treat third party funds as CIAC, the Company should not have assumed that the Commission will approve a radically different type of ratemaking treatment. Id. at 11. Such an assumption the Company makes at its own peril - the Company chose to gamble, and has no one to blame should the Company's request be denied.

RELIEF REQUESTED: The Commission should treat the ICFA proceeds as CIAC and deduct:

PVWC	($10,167,233)
SCWC	($6,105,227)
VWC – Town Div.	$0
VWC – GB Div.	$0
WUGT	($8,721,514)
WVWC	$0

R-2 at 6, RLM-3[2].

FRANCHISE FEE PASS-THROUGH AND PUBLIC PRIVATE PARTNERSHIP AGREEMENT

The issue in dispute between RUCO and the Company concerns the method of collection of the franchise fee. The Company recommends it be permitted to recover a portion of the franchise fee being paid by its parent through an increase in operating expenses and another portion through Private Partnership Agreements ("PPAs" or "P3 agreements"). R-4 at 16. RUCO is recommending the Company be allowed to collect the fee only through an increase in the Company's operating expenses in order to allow the recovery of the Company-requested portion of the franchise fees in rates. Id. RUCO is concerned that the collection of the fees through the PPAs may entice the Company to pass additional types of services that are not related to the franchise fee. Id. at 17. RUCO recommends and wants to ensure that these unrelated expenses that are currently being paid by Global Parent not be recovered in rates. Id. at 18. RUCO's recommendation limits

[2] These are the net adjustments after amortization.

the recovery to three percent of operating revenues and does not allow for a direct pass through to ratepayers. Id. These fees would also be subject to review under RUCO's proposal in the next rate case to ensure only those costs associated with Franchise Fees would be recovered. Id. RUCO's recommendation is one way to assure that these non-related fees are not charged to ratepayers.

RELIEF REQUESTED: RUCO recommends the Company be allowed to increase its operating expenses only to recover the requested portion of the requested franchise fee in rates. Id. at 16. RUCO recommends that any portion of the franchise fees negotiated through P3 agreements (currently being paid for by the unregulated Global Parent entity) that are not associated with services typically included in a municipal franchise fee not be recovered in rates. R-7 at 14.

DISTRIBUTED RENEWABLE ENERGY RECOVERY AND CONSERVATION

The Company seeks to recover its distributed renewable energy recovery tariff through an adjustor mechanism. R-4 at 5. The Company intends to establish a surcharge which will allow it to recover the costs associated with new plant additions that utilize renewable energy technology. Id. RUCO does not oppose the use of plant additions that employ renewable resources such as solar. Id. Nor does RUCO oppose the recovery of those costs that are reasonable and prudent to achieve that end. RUCO does oppose recovery, however, through the use of an adjustor mechanism. Id.

The proposed adjustor mechanism, like the Arsenic Cost Recovery Mechanism ("ACRM") will only consider cost increases in one category of expenses and will ignore changes in revenues, cost of capital, rate base and other expense categories. Ratepayers will not enjoy the benefits of efficiencies or other potential off-sets to costs since the sole

focus of the step reviews will be the costs associated with renewable energy. This is "single-issue" ratemaking and as such, the Court of Appeals in this state has recognized it is "fraught with potential abuse." See *Scates v. Arizona Corporation Commission*, 118 AZ. 531, 534, 578 P.2d 612, 615 (1978). To the extent the Commission is willing to consider such mechanisms, it should only do so under the most dire and extreme circumstances. Approving a mechanism for the recovery of expenditures for plant additions utilizing renewable technology does not qualify for this extraordinary ratemaking device.

The ACRM was the result of a change in the federal law which did not provide water companies with an alternative. R-4 at 8. No one questioned that in order to comply with the new federal arsenic standard, numerous water utilities would have to expend large amounts of capital in a relatively short time to build the infrastructure in addition to the operation and maintenance costs. Id. RUCO, the Commission's Staff and the water utilities all understood the unique situation confronting the water utilities because of the new law and worked hard to come up with a cost recovery mechanism that was fair to ratepayers and allowed timely cost recovery. Id. While the ACRM raises the same concerns raised by the *Scates* Court, the mechanism became unavoidable given the fact of change in the law and its simultaneous impact on a large number of water systems. Id.

There is no federal or state law or regulation which requires the use of solar technology or other renewable resources when a water company builds plant additions. In Decision No. 68302, (In the Matter of Arizona Water's rate application for its Western Group, Docket No. W-01445A-04-0650, docketed on November 14, 2005), the Commission noted that

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> Staff states that adjustment mechanisms have traditionally been used to mitigate the regulatory lag for volatile, very large expense items, and are useful when a commodity constitutes a utility's largest expense, such as for electric utilities where purchased power is the utility's single largest expense (Ludders at 7-8; Ludders Sb. At 6). Decision No. 68302 at 44.

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At issue in the Arizona Water case was the Company's proposed continuance of an adjustor mechanism to recover the cost for power provided to Arizona Water from APS. Id. The Commission denied the Company's request noting that APS' adjuster had numerous safeguards designed to limit volatility and the evidence in that case did not support a finding that the company's power costs were subject to such a degree of price volatility or uncertainty that it justified an adjustor mechanism. Id. at 46. The Commission further concluded,

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Undoubtedly based in part on Staff's conclusions in that case, that consistent with numerous prior and subsequent Commission decisions:

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> There is a danger of piecemeal regulation inherent in adjustment mechanisms. Because they allow automatic increases in rates without a simultaneous review of a utility's unrelated costs, adjustment mechanisms have a built-in potential of allowing a utility to increase rates based on certain isolated costs when its other costs are declining, or when overall revenues are increasing faster than costs due to customer growth. Adjustment mechanisms should therefore be used only in extraordinary circumstances to mitigate the effect of uncontrollable price volatility or uncertainty in the marketplace. Id. at 45-46.

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The Commission also rejected the use of an adjustor mechanism in a recent Chaparral City Water application. Docket No. W-02113A-04-0616, Decision No. 68176 docketed September 30, 2005). In Chaparral the company proposed an adjustor for its purchased water and purchased power expenses that even the Commission determined were significant. Decision No. 68176 at 32-33.

> Staff does not believe that the incremental cost level or volatility associated with possible rate increases or decreases associated with the Company's water supply are significant enough to justify a purchased water adjustment mechanism in this case, and recommends denial of the Company's request. Regarding purchased sewer expense, Staff does not disagree that purchased power expense is a significant cost for Chaparral City, but points out that the issue to be considered in implementing an adjustment mechanism is not merely whether the cost is significant, but whether the incremental cost level, or volatility, associated with possible rate increases or decreases is significant. Staff asserts that future rate increases the Company projects from SRP and APS do not constitute a level of volatility great enough to warrant the need for a purchased power adjustment mechanism. In particular, Staff differentiates the possible increases in Chaparral City's purchased power expense from the volatility; of APS' constantly changing fuel and purchased power costs, which led to the Commission's recent approval of a Power Supply Adjustor for APS. Id.

The Commission agreed with Staff and RUCO that the expenses do not rise to a "…level of volatility that would justify the extraordinary ratemaking treatment…" of an adjustor mechanism. Id. at 33. The Commission concluded:

> As we stated in Decision No. 56450, there is a danger of piecemeal regulation inherent in adjustment mechanisms. Because adjustor mechanisms allow automatic increases in rates without simultaneous review of a Company's unrelated costs, an adjustment mechanism has a built-in potential of allowing a Company to increase rates based on certain isolated costs when its other costs are declining, or when overall revenues are increasing faster than costs due to customer growth. Such circumstances can result in increases to ratepayers through adjustors even when the Company's level of earnings would not warrant a rate increase, such that the utility's net income is increased outside a rate case. In addition, as we stated in Decision No. 66849 (March 19, 2004), adjustment mechanisms may also provide a disincentive for a utility to obtain the lowest possible cost commodity because the costs are simply passed through to ratepayers. For these reasons, adjustment mechanisms should be implemented only under very special circumstances. Based on the evidence in this proceeding, circumstances do not exist in this case to justify the risks of piecemeal regulation inherent in adjustment mechanisms, and we will not approve the Company's requests. Id.

The circumstances in this case do not warrant an adjustor mechanism. The plant costs associated with solar technology do not rise to the level of volatility that it should require extraordinary ratemaking. It has not been shown or even alleged that these costs are not otherwise normal plant expenditures. The proliferation of the number of requests for adjustor mechanisms by utilities in Arizona to recover routine expenses is alarming. Adjustor mechanisms are an exception to this states constitutionally mandated fair value requirement and should only be considered under the most extraordinary circumstance. Those circumstances do not exist here and the Commission should not stretch the exception to include the types of cost under consideration.

RELIEF REQUESTED: The Commission should deny the Company-proposed distributed renewable energy recovery tariff for an adjustor mechanism. R-7 at 5.

PROPERTY TAX EXPENSE

RUCO and the Company used the same methodology to compute property tax expense. R-2 at 6. The difference in the recommendations is that each party's recommendation is based on its proposed level of annual revenue. Id.

RELIEF REQUESTED: RUCO recommends adjusting test-year operating expenses by:

PVUC	$609,679
SCWC	$690,540
VWC – Town Div.	$159,024
VWC – GB Div.	$18,061
WUGT	$9,539
WVWC	$25,108

See RUCO's Final Schedule RLM-8.

INCOME ANNUALIZATION TO RECOGNIZE POST TEST YEAR CUSTOMER LEVELS

RUCO, Staff and the Company are in substantial agreement with the level of revenue and expenses affected by changes in the number of customers served by the Utility and RUCO's adjustment reflects the customer numbers as of July 31, 2009. R-2 at 7. This adjustment reverses the Company's original recommendation, which was based on reduced end of test year customer counts as computed on the Company's Schedule C-2, page 2. Id.

RELIEF REQUESTED: RUCO recommends adjusting test-year revenue and operating expenses by:

	REVENUE	EXPENSES
PVUC	$122,612	$9,516
SCWC	$299,141	$17,931
VWC – Town Div.	$143,041	$24,875
VWC – GB Div.	$43,655	$6,711
WUGT	$0	$0
WVWC	$0	$0

Id.

BAD DEBT EXPENSE

RUCO recommends the unadjusted test year bad debt expense as a fair and reasonable reflection of the historical annual amount.

RELIEF REQUESTED: RUCO recommends adjusting test-year operating expenses by:

PVWC	$30,477
SCWC	($4,657)
VWC – Town Div.	$13,954
VWC – GB Div.	$752
WUGT	($142)
WVWC	($885)

R-2 at 9.

DEPRECIATION EXPENSE

This adjustment is specific to PVUC, SCWC AND WUGT. R-2 at 9. This is a companion adjustment to adjustment made to reclassify ICFA discussed above and reflects the amortization of the CIAC and its reduction to the depreciation expense. R-2 at 5-6.

RELIEF REQUESTED: As shown on Schedule SURR RLM-7, column H, RUCO recommends adjusting test-year operating expenses by:

PVWC	($823,895)
SCWC	($494,849)
VWC – Town Div.	$0
VWC – GB Div.	$0
WUGT	($301,236)
WVWC	$0

Id. at 9-10.

INCOME TAXES

This adjustment reflects income tax expenses calculated on RUCO's recommended revenues and expenses.

RELIEF REQUESTED: As shown on Schedule SURR RLM-7, column G, RUCO recommends adjusting test-year operating expenses by:

PVWC	($529,621)
SCWC	($453,722)
VWC – Town Div.	($26,891)
VWC – GB Div.	$4,167
WUGT	$149,378
WVWC	($4,360)

See RUCO's Final Schedules – RLM-9.

CONTRACTUAL SERVICES – MANAGEMENT FEES

RUCO and the Company are now in substantial agreement with contractual services – management fees. The Company agrees to remove payroll bonus as identified on page 6 of the rebuttal testimony of Company witness Jamie Moe. R-2 at 8.

RELIEF REQUESTED: As shown on Schedule SURR RLM-7, column F, RUCO recommends adjusting test-year operating expenses by:

PVWC	($26,716)
SCWC	($36,448)
VWC – Town Div.	($55,315)
VWC – GB Div.	($7,016)
WUGT	($4,629)
WVWC	($21,372)

R-2 at 8.

CENTRAL ARIZONA GROUNDWATER REPLENISHMENT DISTRICT FEES ('CAGRD')

The Company is requesting Commission approval to collect CAGRD fees through a commodity-based pass-through surcharge. R-1 AT 13. The Company is not being charged any CAGRD fees at this time, because it has not completed the enrollment process. Id. RUCO recommends the Commission deny the Company's proposal to recover the CAGRD fees at this time since the Company is not being assessed the fee.

The CAGRD fee is collected from landowners or water service providers and is used to purchase water (i.e. excess surface water or recycled water), which is then injected into the ground; thus compensating for groundwater withdrawals. However, landowners or water service providers must enroll in CAGRD to participate in the program. Id. Since the Company has not enrolled in the CAGRD at this time, it should be a moot issue from RUCO's perspective.

Nonetheless, the Company desires to recover the CAGRD assessment through a surcharge once it starts to get assessed a fee. Again, this question should be addressed in the Company's next rate case after it has enrolled in the program and is being assessed. Should the Commission believe the issue is ripe now, the Commission should not allow recovery through a commodity based surcharge nor through an adjustor mechanism. The Commission should allow the Company to expense the item which is the standard ratemaking treatment for this type of routine, unexceptional expense.

The Commission has already reviewed and denied a similar request by another regulated water utility (Johnson Utilities, LLC). Id. at 14. In Decision 64598, dated March 4, 2002, the Commission determined that the CAGRD fee cannot be treated as a pass-through

tax, because it is not a "privilege, sales or use tax" since the CAGRD fees are not based on sales revenue. Id. However, In Decision 64598, the Commission also ordered the matter of the CAGRD fee be addressed in Johnson Utilities' next full rate case. On March 31, 2008 Johnson Utilities did file a rate case in which it requested recovery of the CAGRD fee by a commodity-based pass-through surcharge. Id. The difference, however, is that Johnson Utilities is enrolled in the program and is being assessed the fees. As of the filing of this testimony, the Commission has not made a decision on Johnson Utilities rate case. However, RUCO maintains that in this case, like in Johnson, if the Company is assessed a CAGRD fee it should be expensed and not be treated as a pass through or recovered through an adjustor.

RELIEF REQUESTED: The Commission should not allow any adjustment for CAGRD fees at this time. R-1 at 14.

COST OF CAPITAL

CAPITAL STRUCTURE AND COST OF DEBT

Global and RUCO agree on capital structure and cost of debt for each district except for the Palo Verde and Santa Cruz districts. R-7 at 14-15. For the WUGT, RUCO is recommending an operating margin of 8.03 percent due to the negative rate base. R-6 at 51, R-7 at 18. The Company proposes a capital structure of 54.65% equity and 45.35% debt for Palo Verde and 56.07% equity and 43.93% debt for Santa Cruz. R-6 at 50. RUCO's recommended capital structure for both districts is 62.11 percent equity and 37.89% debt. R-6 at 51

RUCO's capital structure recommendation is a blanket capital structure based on the combined amounts of long term debt and common equity of each of Global's six operating

systems. Id. RUCO believes that a capital structure that produces a lower cost of common equity is appropriate for Global because publically traded companies with Global's actual level of equity would be perceived as having average to extremely low financial risk. Id. With the lower risk the investor expectation would be a lower return on common equity. Id. RUCO's recommended capital structure produces a lower weighted cost of common equity which is consistent with the lower risk that the Company faces when compared to the more leveraged companies used in RUCO's proxy of Companies. Id. RUCO's recommendation is also closer to the 40% debt/ 60% equity capital structure which the Commission has favored in the past.

Finally, RUCO's capital structure is supported by the Commission's reasoning in the recent Gold Canyon Sewer Company case (Docket No. SW 02519A-06-0015). Id. In Gold Canyon, the Commission adopted both a hypothetical capital structure and a hypothetical cost of debt in order to remedy a capital structure comprised of 100 percent common equity. In Decision No. 70624, dated November 19, 2008, the Commission noted the following:

> We agree with RUCO's hypothetical structure of 40 percent debt and 60 percent equity. A capital structure comprised of 100 percent equity would be viewed as having little to no financial risk. The proposed capital structure adopted by the Commission will bring the Company's capital structure and weighted cost of capital in line with the industry average and it will result in lower rates for the customers of the system. We therefore adopt a hypothetical capital structure of 40 percent debt and 60 percent equity. Decision No. 70664 at 14.

Likewise, RUCO's recommend capital structure for all of the districts in this case is in line with the industry average and should be adopted.

The difference in the cost of debt recommendations for the Palo Verde and Santa Cruz districts results from the calculations used by the respective parties to ascertain the recommended cost of debt. RUCO calculated a weighted average of the Company-proposed

costs using the projected dollar amounts of long-term debt for each of the six operating systems. The result is RUCO's 6.44 percent cost of long term debt. R-6 at 52. Again, from RUCO's perspective, using the weighted average of all of the districts provides a result that is more in-line with the industry average.

COST OF EQUITY

Both Staff and the Company are recommending a cost of equity of 10.00 percent. S-7 at 20. Neither Staff nor the Company conducted an actual cost of equity analysis. Id. at 21. RUCO is recommending a cost of common equity of 9.00%. Id.

RUCO's recommendation is based on a complete cost of equity analysis. RUCO originally recommended a cost of equity of 8.01 percent. R-6 at 7. RUCO's original recommendation was the mean average of the result of its Discounted Cash Flow ("DCF") analysis and Capital Asset Pricing Model ("CAPM") analyses. RUCO utilized both a sample of publically traded water providers and a sample of publically traded natural gas distribution companies in its analyses. Id. RUCO's analyses also factored in the current economic environment which caused RUCO to change its recommendation in its surrebuttal case. R-7 at 15.

Since RUCO filed its direct testimony on October 26, 2009, the state of the economy has improved. R-7 at 15. The stock market has shown signs of improvement, and there are reports in the financial press which anticipate Federal Reserve actions to raise interest rates. Id. Value Line analysts recently summed up the improving economic situation in its weekly Economic and Stock Market Commentary in its Selection & Opinion publication dated November 27, 2009:

> The long recession has faded into history, brought to an end in the third quarter when the nation's gross domestic product increased by a solid 3.5%. That notable rebound followed four straight quarters of contracting economic activity. The recession was the worst in decades. The third quarter's surge in activity, which was underpinned to some degree by federal programs to assist the troubled auto and housing industries, may not continue to the same degree in the current period. In fact, we expect GDP growth to ease to a level closer to 2.0%-2.5% during the fourth quarter. We think that the evolving expansion will then remain on a similarly subdued path for much of 2010. Thereafter, an increasing level of aggregate demand is likely to develop—with belated help from better employment and housing trends—and push the economy onto a materially faster track by 2011. The 3.0%, or better, pace of economic growth that we see evolving by that time is likely to then continue through the middle years of the coming decade.

Id.

Value Line reported the following:

> Unlike the economy, which has proceeded on an irregular path during the formative stages of its comeback, the stock market, which lost more than half of its value from October, 2007 through March, 2009, has come roaring back. At press time, the Dow Jones Industrial Average was up about 60% from its bear market lows of this past March. However, it was still some 25% below the record highs set in late 2007. The market's revival, which began as the worst fears on the credit and business fronts didn't materialize, has been sustained with an assist from the Federal Reserve, the government's stimulus efforts, and the aforementioned revivals on the economic and profit fronts. Now, with valuations having become a little stretched following eight months of steady market increases, the bulls may have to deliver even more good news to keep the rally going.

Id. at 15-16. Based on these new developments, RUCO increased its recommended cost of equity capital from 8.01 percent to 9.00 percent.

By comparison, neither the Company nor Staff changed their cost of equity analysis to reflect the changes in the current economic environment. The Company's recommended 10 percent cost of equity adopted in prior Commission decisions, there was no need to counter RUCO's analysis. A-13 at 38. The Company's position is that developing an independent

cost of equity analysis is expensive and time consuming. Id. at 36. Staff and the Company believe that recent Staff recommendations in the Arizona-American case (Docket No. W-101303A-08-0227) and Commission decisions are in line with the Company's recommendation and that is enough to support its position. Id. at 37, A-12 at 28.

Staff relied on it's "…underlying analysis" from the recent Black Mountain case (Docket No. SW-02361A-08-0609) which Staff believes can be reasonably applied to the current case since the analysis is "…current and is based on a sample of water companies." S-10 at 29. It appears that Staff is suggesting that it is no longer necessary to do a cost of equity analysis for a utility if there is a current case pending that used a sample of the same type of utilities in its cost of equity analysis. There is no question that this approach would steam-line the analysis and save on the costs, but it would come at the expense of a well reasoned, well thought out and fair cost of equity recommendation.

Even Staff acknowledges that there are "…differences in circumstances between utilities that can cause differing results in the specified estimated equity costs for each." Id. One would think that any argument in favor of Staff's stream-lined approach would end there. After all, Staff has acknowledged the exact reason why any possible benefit of stream-lining the process would be out-weighed by the harm of a methodology that does not distinguish the differences in circumstances that exist between Black Mountain and Global. Surprisingly, Staff simply disregards the differences in circumstances in favor of convenience.

Finally, the Commission itself has recently dismissed Staff and the Company's argument. In the appeal of Gold Canyon Sewer Company, currently pending before the Arizona Court of Appeals, the Commission addressed a similar argument made by Gold Canyon. Commission Docket No. SW-02219A-0015, No. 1 CA-CC-09-0001, 0002. On appeal, Gold Canyon argued that in a rate case involving its affiliate, Black Mountain Sewer

Company the capital structure component of the cost of capital analysis were virtually identical and therefore entitle to the same outcome. See Appellee Arizona Corporation Commission's Responsive Brief at 38. Therefore, argues Gold Canyon, any other outcome would be arbitrary and unlawful.

In response, the Commission argues that there are a number of factual differences between Gold Canyon and Black Mountain, noting the differences in rate base, customer count and the size of the proposed rate increase. Id. at 38-39. The Commission went on to argue:

> The issues presented in a rate proceeding, the positions advanced by the parties during the proceeding, and any other factors that the Commission deems relevant may all contribute to different treatment at different times, if warranted. Id. at 40.

Not surprisingly, the Commission in responding to Gold Canyons' argument argued:

> The Commission decides each case on the record before it. The issue is whether the Commission's decisions on rehearing are supported by ***substantial evidence*** in the record. The Company has not demonstrated that the Commission's decision in Black Mountain binds the Commission to certain determinations in Gold Canyon, nor has the Company shown that the Commission's decisions on rehearing are not supported by substantial evidence in the record. Id at 41. (Emphasis added).

The matter here is not on rehearing and the focus here is on cost of equity and not capital structure, however the standard is the same and the focus is on cost of capital so the analogy is certainly relevant. In this case, as concerns the cost of equity neither the Company nor Staff have "… demonstrated that the Commission's decision in Black Mountain binds the Commission to certain determinations in…" in this case.

Should the Commission adopt Staff and the Company's approach, the Commission would be establishing a precedent that favors convenience over a thorough and complete

financial analysis- a very dangerous precedent – especially concerning a ratemaking element as important as a utilities cost of equity. It is true that estimating an appropriate cost of equity is more of an art than a science, but each utility is different from a financial standpoint in so many ways that applying a generic approach to estimating a cost of equity is simply misplaced and would establish bad policy.

The differences are many, substantial and obvious - Black Mountain, Arizona American and Global all have different operating expenses and operating revenues. Each has different capital structures and rate bases. Each utility has a different parent company, a different level of growth, a different level of risk. Each utility and parent has different operational philosophies which could affect its cost of equity. Global Parent has spent millions and millions of dollars on acquiring distressed utilities with little or no ratebase in its efforts to achieve TWM, a philosophy not shared by Black Mountain or Arizona American. Global's Parent as well as Global Utilities has made it clear that they do not favor CIAC as a means of financing plant. CIAC shifts the risk from the utility and the ratepayer back to the developer. R-7 at 7-8. CIAC reduces the Companies overall risk which, all things being equal, lowers the CAPM results which lowers the cost of equity. Again, all of these circumstances are different and show why a generic application of another utilities cost of equity analysis should not be applied to Global.

Moreover, as made clear above, neither Staff nor the Company's recommendation is supported by substantial evidence. In order to survive a challenge on appeal, the Commissions decision must be supported by substantial evidence. [1] *Tucson Elec. Power Co. v. Arizona Corp, Comm'n*, 132 Ariz. 240, 243, 645 P. 2d 231, 235 (1982). So even is the Commission determines that Staff and the Company's proposals are fair, they still are not supported by substantial evidence based on the record in this case. Neither Staff nor the

Company did a cost of equity analysis so there is no question that their recommendations are not based on substantial evidence. The Commission should reject Staff and the Company's cost of equity recommendations.

RELIEF REQUESTED: The Commission should adopt RUCO's recommended blanket capital structure for Palo Verde and Santa Cruz districts of 62.11 percent equity and 37.89% debt. The Commission should also adopt RUCO's recommended operating margin of 8.03 percent for WUGT. Id. at 51, R-7 at 18. Further, the Commission should adopt RUCO's recommended cost of common equity of 9.00%. R-7 at 21.

RATE DESIGN

RUCO's proposed rate design is consistent with the Company's proposed rate design, but reflects RUCO's recommended revenue requirement. R-8 at 3. RUCO's recommended rate design is based on cost of service. RUCO did not prepare a consolidation proposal because RUCO is not convinced that the Company's consolidation proposal is in the best interests of the ratepayers whose rates would be based on cost of service – Palo Verde, Willow Valley and Santa Cruz ratepayers. R-5 at 3.

The Company is proposing to consolidate only three systems (Valencia Town, Valencia Greater Buckeye and Water Utility of Greater Tonopah. Id. The Company's explanation for only partial consolidation of the all the districts is to mitigate rate shock for one of the systems – WUGT. R-5 at 3. The costs for WUGT would shift to the customers of the other two systems. Id. The Company argues that WUGT's 360 customers will face an extremely large rate increase without consolidation. Id. at 4. According to the Company, WUGT required substantial upgrades, including arsenic and fluoride treatment, point of use treatment systems and infrastructure which was mandated by Commission orders. Id. All

three of the utilities that the Company proposed be consolidate have a total of 6,000 customers. Id. From the Company's perspective, the aforementioned infrastructure costs can be spread across this larger customer base. Id.

The problem with the Company's perspective is that Valencia Town and Valencia Greater Buckeye's ratepayers are unlikely to derive any meaningful contribution toward any reciprocal infrastructure improvements from WUGT's ratepayers in the future. Id. at 4-5. Valencia's ratepayers would bear the brunt of subsidizing WUGT. Accordingly, RUCO believes that consolidation in this case is not in the best interests of all of the ratepayers, and particularly Valencia's ratepayers.

PHASED-IN RATES

RUCO is recommending that the Commission adopt the Company-proposed three-year phase-in of rates for Palo Verde Utilities Company that will generate RUCO's recommended level of operating revenue. The Company is also requesting phased in rates for the Palo Verde Utilities Company wastewater operating system.

In the absence of a phased-in rate proposal, there would be a drastic rate increase for Palo Verde Utilities Company ratepayers. Id. at 7. Under RUCO's recommended level of operating revenue, ratepayers would experience a monthly charge of $58.63 per month or a 77.66 percent increase in existing rates. This amounts to an additional $25.63 per month over the present rate of $33.00 per month. Given the magnitude of the increase and current economic conditions, RUCO agrees with the Company that phased-in rates are warranted. See RUCO's Final Schedules RLM-RD-3.

REBATE THRESHOLD RATES

Global Utilities is requesting a volumetric rebate that allows residential customers, who achieve reductions in water consumption, to realize an immediate reduction in volumetric charges when their consumption level is below a rebate threshold volume amount. R-5 at 8. The volumetric rebate is one of a three element plan that makes up the Company's Rebate Threshold Rate ("RTR") structure. The other two elements include six volumetric tiers, as opposed to the more common three tier rate structure, and revenue decoupling through an increased minimum monthly charge. Id.

RUCO is recommending that the Commission adopt the Company-proposed six tier rate structure and has increased the minimum monthly charge for each of the five water providers included in the Company's filing. Id. at 8. RUCO, however, does not support the Company's proposal regarding the volumetric rebate or the decoupling proposal. RUCO believes that the six-tier rate structure and the increased monthly minimum will send a proper price signal to conserve water. Id. While RUCO definitely supports programs to encourage water conservation, RUCO believes that the volumetric rebate is flawed because the rebate will not properly incent conservation because rebates are awarded to all customers who consume less than the median amount, regardless of whether those customers have always been below the median point prior to the implementation of the rebate program. Furthermore, rebates would not be given to those high use customers who demonstrably reduce their consumption, yet still fall above the median amount. Id.

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CONCLUSION

RUCO recommends that the Commission treat the ICFA proceeds as CIAC.

RUCO further recommends the Commission should adopt RUCO's recommended capital structure for Palo Verde and Santa Cruz districts of 62.11 percent equity and 37.89% debt and an operating margin of 8.03 percent for WUGT. Id. at 51, R-7 at 18. Further, the Commission should adopt RUCO's recommended composite cost of common equity of 9.00%. R-7 at 21.

Finally, in addition to all of the other recommendations listed in this Brief, RUCO recommends that the Commission adopt RUCO's rate design, impose a three-year phase in of rates for Palo Verde Utilities Company, and reject the Company's volumetric rebate proposal and decoupling proposal.

RESPECTFULLY SUBMITTED this 5th day of February, 2010.

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