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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

DOUG LITTLE - CHAIRMAN
BOB STUMP
BOB BURNS
TOM FORESE
ANDY TOBIN

ARIZONA CORPORATION COMMISSION INVESTIGATION INTO POTENTIAL IMPROVEMENTS TO ITS WATER POLICIES.	DOCKET NO. W-00000C-16-0151 **DECISION NO.** 75626

Arizona Corporation Commission
DOCKETED
JUL 25 2016
DOCKETED BY

Open Meeting
June 24, 2016
Phoenix, Arizona

BY THE COMMISSION:

The Commission having given due consideration to these matters and balancing these matters in the public interest, finds and concludes that it is in the public interest to adopt and approve the Statements of Commission Policy in Attachment No. 1 and Attachment No. 2 to this Order. Attachment No. 1 is the Commission's Policy Statements for the Water and Wastewater Industries proposed by Chairman Little, and as modified, adopted and approved by the Commission at its June 24, 2016 Open Meeting. Attachment No. 2 is the Commission Policy Statements for Small Water System Emergencies proposed by Commissioner Tobin, and as modified, adopted and approved by the Commission at its June 24, 2016 Open Meeting.

We direct Commission Staff to publish notice of these Commission Statements of Policy as appropriate.

ORDER

IT IS THEREFORE ORDERED that the Statements of Policy in Attachment No. 1 and Attachment No. 2 to this Order, are hereby adopted and approved by the Commission.

IT IS FURTHER ORDERED that Commission Staff shall publish notice of these Commission Statements of Policy as appropriate.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN LITTLE

COMMISSIONER STUMP

COMMISSIONER FORESE

COMMISSIONER TOBIN

COMMISSIONER BURNS

IN WITNESS WHEREOF, I, JODI JERICH, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this 25th day of July, 2016.

JODI A. JERICH
EXECUTIVE DIRECTOR

DISSENT: _____

DISSENT: _____

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ATTACHMENT NO. 1

DECISION NO. 75626

Commission Policy Statements for the Water and Wastewater Industries Proposed by Chairman Little and as Modified, Adopted and Approved by the Commission at its June 24, 2016 Open Meeting

Introduction

The private water utility industry in Arizona is highly fragmented and problematic. This Commission has seen first-hand the extent to which small water utilities sometimes struggle both financially and operationally. The struggles of these companies can have direct impacts on the service they provide to their customers. Consolidating the small systems through purchases by larger systems has long been proposed as a solution to the problems associated with small systems and this Commission has endorsed consolidation through purchase at various times over the past decades. We recognize that consolidation can be an effective method of solving problems associated with small systems and propose several policies here to encourage consolidation directly. However, we also recognize that consolidation cannot solve all problems; some small systems may never be consolidated due to practical reasons and some small systems are perfectly capable of providing quality service without consolidation. Therefore, we are also proposing policies here aimed at alleviating the unnecessary regulatory burdens that small companies face when dealing with the Commission. The aim here is to allow the smaller companies and Commission Staff to get through rate cases with a focus on efficiently establishing just and reasonable rates and to deemphasize aspects of the rate case process that stray from that core mission.

Allowing for more efficient rate cases and encouraging consolidation will have direct and tangible benefits for small water utility customers. When small utilities do not file rate cases for extremely long periods of time they will almost inevitably end up in a situation where their expenses and capital needs are difficult or impossible to meet. This results in service quality problems that impact customers directly. And when companies in this situation eventually do file rate cases, the cases are more complex (due to, e.g., the long period of time the rate base audit will cover and due to the assessment of engineering improvements that have to be made) and the rate increase that ultimately comes out of the case will be larger resulting in "rate shock" to the

customers. A situation where companies come in for smaller rate increases more frequently would result in healthier companies, safer and more reliable water and less agitated customers. We do recommend that small utilities file rate cases (or at least seriously examine whether a rate case filing is necessary) at least every 5 to 7 years. However, requiring them to do so would not be good policy. Rather, we should create an environment where utilities will do so voluntarily.

Similarly, troubled small water systems that are acquired by larger entities will have access to the capital and expertise necessary to make tangible improvements in service quality. And if rate-consolidation is adopted the rate impact of necessary capital improvements to small systems may be significantly less than it would be otherwise.

While the focus and impetus of this Policy Statement is on smaller utilities, we also recognize that the regulatory burden on larger water utilities can be significant and costly (and those costs ultimately are passed on to customers.) Therefore we propose here policies that will streamline the rate case process for larger companies as well.

The proposals and issues discussed here are not new. This Commission has recognized and discussed these issues since (at least) 1998 when the Commission's Water Task Force[1] was formed to develop recommendations dealing with essentially the same issues discussed herein. Over the intervening years these issues have come up repeatedly in rate cases and other dockets. We believe it is time to provide clarity to the Commission Staff and to Arizona's water utility industry on the Commission's stance on the issues discussed below. Processing water utility rate cases is one of the core missions of this Commission and as such it is appropriate that the Commission provide clarity on these issues.

Policy Statement No.1
Small Water Company Rate Case Issues

The rate case process is potentially difficult and intimidating for small water utilities. Small utilities do not typically have professional regulatory accountants or rate experts on staff to

[1] W-00000C-98-0153.

1 prepare and file such cases, deal with discovery, work with Staff and bring the case to conclusion.
2 When small utilities are unable to prepare a rate case or complete the rate case process, their rates
3 will become out-of-date due to inflation and other factors, affecting their financial viability as well
4 as their ability to fund necessary maintenance and capital improvements. This can lead to service
5 quality issues and to rate shock for customers when rates are finally increased.

6 The Arizona Administrative Code as it pertains to rate cases[2] allows smaller companies to
7 file fewer schedules than larger companies. The Commission also provides a "short form" rate
8 application for small water utilities.[3] Further, our rate case time-clock rule[4] requires a faster
9 process for smaller companies. We recently updated the utility classifications, which is another
10 measure that should help smaller companies.[5] We also worked with the Legislature to amend
11 A.R.S. § 40-250 to remove the hearing requirement for utilities with intrastate gross operating
12 revenues of less than one million dollars.[6] In spite of these efforts to reduce the regulatory burden
13 on small water utilities, many small company rate cases can, when issues are contested, become
14 lengthy and extend well beyond specified processing timelines.

15 Listed below are specific policies we adopt to lessen the regulatory burden on small water
16 utilities while continuing to ensure customers are protected.

17 1. Encourage use of the Class Spokesperson Procedure: We encourage public participation in
18 rate cases, and recognize that value and perspectives that intervenors bring to rate cases. However,
19 participation by multiple intervenors in a small utility rate case can increase the expense of the
20 case substantially. Accordingly, we encourage the Hearing Division to use the class spokesman
21 procedure in A.A.C. R14-3-105(C) in appropriate cases to ensure that intervenors do not unduly
22 prolong the process. Employing this procedure can also lessen the expense on the intervenors
23 themselves since it will reduce the amount of filings they will have to make and will allow them

[2] A.A.C. R14-2-103.
[3] http://www.azcc.gov/Divisions/Utilities/forms/2016WaterRateApplicationUnder1M-draft.pdf
[4] A.A.C. R14-2-103(B)(11).
[5] *See* Notice of Final Rulemaking at 20 Arizona Administrative Register 3439 to 3445.
[6] *See* A.R.S. § 40-250, which was amended in 2015 by S.B. 1098. Previously, utilities with revenues under $250,000 were exempt.

to pool their resources. In addition, as with all discovery, intervenor discovery should not be unreasonable or disproportionate to the amounts at stake.

2. Allow for Emergency Surcharges: A Class C, D, or E water or wastewater utility that faces a water supply emergency (such as a failed well, pump, or tank) may request an emergency surcharge. The emergency surcharge procedure will comply with all legal requirements for an "emergency rate case". The emergency surcharge shall be based on the estimated costs of water hauling, repairs or replacement plant. The emergency surcharge may be based on a ten-year amortization based on the interest rate for any loan anticipated to fund the repairs or replacement plant, or on the cost of debt approved in the most recent "Class A" water utility rate case. A reasonable deadline for expiration of the surcharge should the utility not file a rate case may be established. The legal requirements for "emergency rate cases" are not contained in statute or the Administrative Code but rather are contained in various court cases and at least one Attorney General's opinion. As such, the Commission directs Commission Staff, including the ACC Hearings Division, to collaborate with the Residential Utility Consumer Office, the Water Utilities Association of Arizona and the Rural Water Association of Arizona to evaluate the Commission's current processing times for Emergency Surcharges and report back to the Commission by September 1, 2016 with an appropriate recommendation on two processes that allow a water or wastewater utility to receive a Commission vote on an emergency surcharge within 30 days and 60 days after filing an initial surcharge application.

3. Allow for Purchased power and Water Adjustors for Small Utilities: We have sometimes approved purchased power adjustors and purchased water adjustors for larger water companies. We will consider requests for such adjustors from smaller utilities as well—there should be no minimum utility size required for adjustor mechanisms. Staff is directed to update the Short Form Rate Application to include schedules necessary for calculating purchased power and water adjusters. The revised Short Form rate application will be available for Commission review by September 1, 2016.

4. Allow for System improvement Funds: In rate cases for Class D or E water or wastewater utilities, we will consider establishing a fixed surcharge to fund a "system improvement" fund and/or an "emergency repair and replacement" fund. Many small utilities find themselves in a situation where their actual revenue has been insufficient to cover needed improvements. The operating margin or ROE adjustments to reflect increased business risks as contemplated in "Cost of Capital Reform and Income Issues Policies" may offset or even eliminate the need for system improvement surcharges.

Requests for these surcharges will be considered on a case-by-case basis. Surcharges will be capped, and funds from each surcharge must be strictly tracked and spent only for the specified purposes. We will require surcharge funds be deposited into separate, segregated bank accounts. Any such surcharges will continue until the utility's next rate case. The surcharge amount will not change between rate cases. Staff is directed to update the Short Form Rate Application to include schedules necessary for calculating system improvement surcharges. The revised Short Form rate application will be available for Commission review by September 1, 2016.

5. Insure Staff Reports Are Sufficiently Informative: In order to allow the Commission to fully evaluate the recommendations of Staff in small water utility rate cases the following information will be included in all future Staff Reports (or testimony if applicable) on Class C,D, and E water rate cases:

a. A Cash Flow schedule that clearly shows Staff's calculation of Free Cash Flow. For small companies Free Cash Flow is an extremely important statistic and is sometimes used as the basis for ratemaking. Therefore, it is very important that the Commission, the ALJ and the Company understand Staff's calculation of free cash flow. Staff currently reports a Free Cash Flow number (without a schedule showing how it is developed) so this requirement does not require any new calculations.

b. A schedule that clearly shows how much revenue (in absolute and percentage terms) is generated by the basic service charge and each of the commodity tiers for the Company's present rates, the Company's proposed rates and Staff's proposed

rates. As discussed below, rate design is an essential part of the ratemaking process. It is essential that there be transparency with respect to the implications of whatever rate design is being recommended.

c. A statement that clearly explains what method Staff used to generate the revenue requirement (Rate Base Rate of Return, Operating Margin, or Cash Flow) and explains why the method used is preferable to the other potential methods. The Staff Report should also include the amount and nature of the operating contingency that Staff included in the revenue requirement, including the assumptions Staff used in making that calculation.

6. Establish Standard of Materiality: Audits performed by Staff on small water companies should focus on issues likely to materially impact rates. Accounting issues that have minimal impact on rates need not be addressed in small water utility rate cases. Staff will establish standards of materiality that take into account rate impacts. Staff will not request invoices or other information from companies if the amount in question is too small to have a material impact on rates and/or if the information is not directly relevant to rate setting. The standard of materiality will be submitted for Commission review by September 1, 2016. The current standard of materiality Staff uses (*FRA Staff Issue Discussion Memorandum Materiality, January 2014*) has a high level discussion of what types of *adjustments* are appropriate but does not discuss what types of *data requests* are appropriate.

7. Allow for Collection of Lost Revenue: We recognize that small water companies may be reluctant to respond to Staff's recommendations or engage in debate with Staff, either because of ignorance of the process, fear of a bad result and/or fear of a delayed process. Staff reports should clearly and prominently state that they are recommendations only and that the applicant has a right to respond. In order to alleviate the potential reluctance of small water companies to fully participate in the rate case process due to fear of delay, if a Class C, D or E rate case is not completed in the timeframe specified by the Arizona Administrative Code, when new rates ultimately are approved a surcharge mechanism may be established that collects the "lost revenue"

associated with missing the deadline. The lost revenue will be calculated as the revenue that would have been collected under the approved rates had they been effective on the day the time-clock specified in the Arizona Administrative Code expires up to the date the new approved rates actually are effective. If the cause of the delay can clearly be linked to the Company's actions the Commission may choose not to impose the above surcharge.

8. Establish a process for the Small Water Systems Fund: The Commission has been authorized to provide recommendations for the approval of grants from the Small Water System Fund for some time.[7] In spite of this authorization, the SWSF has not had a source of funding for some years until recent legislation provided $500,000. We believe a simple process that insures the fund is used for real emergencies at utilities that legitimately cannot afford repairs while at the same time does not impose unnecessary red tape on the struggling utility is advantageous. As such, we adopt a modified version of the process outlined below:

a. The Commission directs ACC Staff to process applications for emergency monies from the Small Water Systems Fund in the following manner:

1. The ACC Utilities Director receives request from Interim Operator or Interim Manager (IO/IM) for funding. Upon receipt, the Director shall transmit a summary of the request to the Commissioners, the ACC Executive Director, the Water Infrastructure Finance Authority (WIFA), and the Water Emergency Team (WET). Also upon receipt, the Director shall open a docket to act as a repository for documents concerning the request for funds, if no other appropriate docket is already open.

2. Within two weeks after receiving the initial application for funding, the ACC Utilities Division Staff shall evaluate the application, including a determination of the status of existing infrastructure, reasonableness of estimated cost to remedy, and financial circumstances of the requesting

[7] A.R.S. § 49-355.

company in order to correct or avoid an interruption of service, and make an appropriate recommendation to approve or deny funding to the applicant.

3. If ACC Staff recommends approval, then the Chairman shall call an ACC Staff meeting as soon as practicable to discuss and possibly vote on the favorable recommendation. ACC Staff shall draft a letter to WIFA to discuss with the Commissioners at that meeting. If the Commission votes to approve the recommendation, the WIFA letter is to be signed by the Chairman and sent to WIFA. The Commission may also order that the Company file a financial improvement plan (with a reasonable deadline in light of the emergency situation).

4. If ACC Staff recommends against approval, then ACC Staff shall immediately notify the Commissioners, the ACC Executive Director, WIFA, and WET with a summary of the reasoning behind the denial. ACC Staff shall also discuss with the Commissioners at the next regularly scheduled ACC Staff Meeting their reasoning for why approval was not recommended.

b. Pursuant to WIFA Board of Directors Resolution 2016-021, WIFA will process Commission recommendations for emergency grants from the Small Water Systems Fund in the following manner:

1. Upon receipt of the recommendation letter from the Commission, the WIFA Executive Director will review the docketed ACC Staff recommendation and Commission approval documentation and make a determination of whether to approve such grant from the Small Water Systems Fund. According to WIFA Staff, they understand that the IO/IM will have demonstrated need through the initial application process to the ACC.

2. The WIFA Executive Director may only give approval if:

i. WIFA has received a recommendation to provide such grant from the Commission; and

ii. The IO/IM has sufficiently demonstrated [in its initial request to the ACC] that it requires immediate financial assistance to replace, make repairs to or to rehabilitate the public water system infrastructure that is operated by the interim operator or interim manager in order to correct or avoid an interruption in water service.

3. The Executive Director is authorized by the WIFA Board to sign any document and take such actions as necessary and appropriate to consummate the transactions contemplated by WIFA Board Resolution 2016-021.

c. If the WIFA Executive Director gives a favorable review of the application, then WIFA will notify the recipient of the approved grant.

d. The grant recipient would then incur cost and submit a reimbursement request to WIFA and ACC for payment.

e. The ACC/WIFA Engineering Staff would conduct a site inspection of the completed work, and the Approval to Construct (or related documentation) will be sent to WIFA.

f. WIFA would then disburse the grant proceeds to the IO/IM or vendor performing the services.

g. The Utilities Division will keep records sufficient to comply with the reporting requirements of House Bill 2695 Sec. 150(C). That section requires financial reporting on the fund by August 1, 2017, but the Commission directs Staff to keep records on the funds disbursements continuously so that the disposition of the fund can be ascertained at any time.

9. Revise Short Form Application: The short form rate application available on the Commission's web page is in need of revision. Some of the information it asks for is unnecessary and it does not ask for some necessary information that is routinely acquired through data requests. Staff will update the short form rate application and circulate an updated application to the Commission by September 1, 2016. Specific comments and questions regarding the short form are contained in Exhibit A to this document.

Policy Statement No. 2
Rate Design Issues

Arizona is an arid state. Both our urban and rural areas must grapple with scarce water supplies. This has always been true but the current multiyear drought has highlighted the importance of conserving our most important natural resource. Arizona's record in dealing with its water challenges is exemplary, the building of the Central Arizona Project and the passage of the Arizona Groundwater Management Act show real commitment to addressing the challenges of living in an arid environment.

This Commission too has worked towards the goal of water conservation. By embracing three-tiered increasing block rate structures this Commission has shown a willingness to consider water conservation as one of the principle components of rate design. The Commission's embrace of water conservation via three tiered increasing block rate structures was a divergence from traditional rate making with its focus on revenue recovery.[8] While we continue to believe that there is value in promoting conservation through three tiered rates, we also recognize that they have been problematic. The problem with increasing block rates is that they have actually worked. We have seen that in response to being presented with three tiered rates customers have decreased their usage. In some cases they have decreased their usage significantly. This has resulted in many instances where companies have been unable to attain their Commission authorized revenue requirement.

[8] The closest Bonbright, et. al.'s discussion of rate design comes to addressing conservation is a passing mention of externalities, Principles of Public Utility Rates, Second Edition, at Chapter 16: Criteria for a Sound Rate Structure.

The Commission has recognized this problem with respect to large water utilities and has allowed for "conservation adjustments" to the revenue requirement to address it.[9] We continue to support conservation adjustments for large water utilities but we are aware that the revenue erosion caused by conservation can be far more harmful to small utilities. The revenue requirement of a small utility may be especially dependent on revenue generated from a small number of high gallon consumers and thus all it would take is one or two of the high consumption consumers conserving to make attaining the authorized revenue requirement impossible. We believe there is some value in allowing small water utilities to utilize a conservation adjustment as well.

All utilities should have a reasonable opportunity to achieve their authorized revenue requirements. To that end, rate designs should be implemented on a transparent and consistent basis across all utilities. This has been a problem in the past. In fact, three tiered rates have largely been implemented on an *ad hoc* basis and has lacked consistency and transparency.

Another concern with three tiered rates is the rate shock they may impose on high use customers. It may be assumed that high use customers are all high income customers but that is not necessarily the case. High use customers may have high incomes and large pools, water features, extensive landscaping and/or livestock. But they may also be moderate or low income people with large families living together in one residence. Excessive top tier rates could be detrimental to such customers. So we should not be callous in our assessment of appropriate rate design.

Water rate design must balance the three (competing) objectives of promoting conservation, customer fairness and allowing a meaningful opportunity for the utility to recover its authorized revenue. We recognize that balancing these objectives has not been easy. The Staff, the utilities and various interveners have struggled with how to appropriately balance these issues. Based on the experience gained to date we offer the below policy direction that is intended to

[9] *See* Decision No. 74081 (Arizona Water's 2012 rate case) for example.

alleviate the problems discussed above and to alleviate costly debate on these issues during rate cases.

1. General Statement of Rate Design Policy: It is the policy of this Commission that water rate design should:

a. Encourage the conservation of water.

b. Take customer impacts into account.

c. Provide a meaningful opportunity for recovery of authorized revenue.

In order to appropriately balance these three general policies the Commission provides the following direction:

a. The default water utility rate design will be a three-tier increasing block rate design with a non-discretionary usage tier (Rate Tier 1) applicable only to residential customers. Additional rate tiers and other rate design elements may be appropriate where appropriate analysis and justification is provided.

b. Large commercial or industrial customers, large master-metered customers or large standpipe customers should be considered separately from the general rate design for typical residential and other commercial users.

c. Significant changes in rate design for a single water utility may require several rate cycles before applicable targets are reached. Gradualism should guide these transitions in order to reduce disproportionate customer-specific impacts, as well as assuring the utility's revenue recovery. In the event significant capital investment is necessary, then in addition to gradually increase rates, the Commission may include a "capital improvement" surcharge to accelerate such repairs.

d. Case specific departures from standard rate design requirements and revenue targets should be given full consideration when they are supported with factual information and explanations.

2. Statement on Conservation Adjustments: Because adopting inverted block tiered rates is intended to lead to reduced water use by customers, it is likely to lead to under recovery of revenue. For this reason we endorse the use of Conservation Adjustments to revenue requirements. Larger utilities are capable of presenting a case justifying a particular adjustment. We endorse the use of these adjustments for large utilities. Smaller utilities typically lack the expertise necessary to provide the same level of analysis of usage that a larger utility would. However, we believe small utilities should be able to avail themselves of Conservation Adjustments. We direct Staff to adopt a formulaic method that will allow small utilities who are eligible to use the Short Form rate application to calculate a Conservation Adjustment. This formulaic method will be available for Commission review by September 1, 2016. Staff can work with the WUAA and/or other members of the industry in developing this method. Upon acceptance by the Commission, this formulaic method for calculating a Conservation Adjustment will be included in the Short Form rate application available on the Commission's website.

3. Specific Policy on Implementation of Three Tiered Inclining Block Rates: In order to provide clarity and consistency to all rate case participants we provide the following policy guidelines for how Three Tiered Inclining Block rates should be structured:

a. The Basic Service Charge and the 1st tier of the volumetric rates taken together will generate *at least* 50% of the total revenue requirement.

b. The third or top tier will be designed to generate *no more than* 20% and *no less than 10%* of the total revenue requirement.

These policy guidelines allow for flexibility while ensuring that rate designs do not unreasonably skew revenue recovery to the higher tiers. Deviation from the above policy guidelines for application of three tiered rates should be considered when factual circumstances merit it.

Policy Statement No. 3
Cost of Capital Reform and Income Issues

In rate cases for larger water utilities, determining the appropriate Cost of Capital to use in utility rate setting is often a contentious and expensive process. Outside experts on the subject are often employed at considerable expense by the utilities and the interveners. Considerable Staff time and resources can go towards developing Cost of Capital testimony. The recommendations of these experts rarely change considerably from one case to the next. The arcane nature of this expert testimony raises the question of how much value it actually provides to the Commission in its decision making. This expert testimony consists of taking data from a proxy group of companies (large publicly traded utilities) and running that data combined with various other assumptions through several different financial models. It seems that a more efficient way to deal with the issue would be desirable.

Small water utility rate cases have a different problem with respect to Cost of Capital: their low rate bases often mean that the rate base rate of return method cannot be (or at least should not be) used to determine the revenue requirement because it would not result in just and reasonable rates. In these cases the Commission has employed an operating margin based method or a free cash flow based method. However, there is no clear policy regarding which of the three methods is most appropriate or regarding what circumstances would lead us to favor one of the methods over the others. With respect to the operating margin and free cash flow methods, there is also no clear policy regarding what level of operating margin or free cash flow is appropriate.

When a company has zero or negative rate base then obviously the rate base rate of return method cannot be used to set rates. In these cases rates must be set based on a targeted operating margin or free cash flow. But which is more appropriate: operating margin or free cash flow? And what level of operating margin or free cash flow is an appropriate target? What is an appropriate operating contingency given the size, assets, and risk profile of the company? Providing guidance on these questions will help the Staff and the regulated companies as they develop and review rate case applications.

In the past Staff has stated on the record that small companies with negative rate base should only be afforded a "nominal" amount of free cash flow.[10] We reject this notion and note that negative rate base is most often the result of financing decisions made decades ago. Typically, negative rate base results from the use of AIAC to fund plant one or two decades in the past. We note that the use of AIAC has been endorsed by both the Staff and the Commission. We believe it is not appropriate to financially hobble companies in perpetuity because ten or twenty years ago a choice was made to avail themselves of a financing method that the Staff and Commission have endorsed.

To address the problems discussed above we endorse the following statements of policy and provide direction to Staff:

1. Increased risk faced by small water companies: Class C, D and E water or wastewater utilities face significantly increased business risk as compared to larger water and wastewater utilities. These firms are simply not able to raise capital on the same terms as the much larger companies included in the proxy groups for determining cost of equity. Additionally, they have very little ability to diversify their business risks (e.g., losing just one large customer can have significant revenue impacts, or a single necessary repair can raise expenses enough to eliminate a small company's income.) We believe this increased risk faced by small companies should be considered in the ratemaking process. It is the policy of this Commission to recognize this increased business risk.

Below we establish a process to review the ROE processes in California and Florida for possible adoption in Arizona. We direct that this process should include investigation of business risk for small utilities including consideration of establishing minimum operating margins and the use of ROE adders for Class C, D and E water utilities. A reasonable operating contingency should be included in these calculations.

[10] *See* Docket No. W-02031A-10-0168, Transcript of 10/19/2011 Hearing, Volume II, Page 252, line 15.

2. Establishing revenue requirements for Class C, D and E water companies: In order to maintain quality and safe water service and remain financially healthy water utilities must maintain minimum operating margins. For cases where the use of standard rate base rate of return methods will not result in just and reasonable rates, a process should be established to develop a minimum operating margin standard (either based on the methods used in Florida or California or a new method may be adopted) for Class C, D and E water utilities.

The minimum operating margin will be used to develop revenue requirements (and the return on rate base when applicable.)

3. Examination of Florida and California Commissions' small water utility policies: Both Florida and California have large numbers of small water utilities and have historically had similar problems with those small utilities as has Arizona. The Florida Public Service Commission and California Public Utilities Commission have instituted policies aimed at alleviating the regulatory burden on small water utilities and rationalizing the ratemaking process for small water utilities. Commission selected personnel, in collaboration with other interested parties, will examine the policies of the Florida and California Commissions pertaining to small water utilities and will provide a report along with recommendations for policy changes.

4. Examination of Florida and California Commissions' Generic ROE Policy: It is our understanding that the Florida and California Commissions both employ a standardized or generic ROE policy. Commission selected personnel, in collaboration with other interested parties, will examine the policies of the Florida and California Commissions pertaining to standardized ROEs for use in rate cases and will provide a report along with recommendations for policy changes.

We believe that the above reports regarding policies of the Florida and California Commission's should be completed within 90 days. Parties will have an opportunity to comment.

Policy Statement No. 4
Water Utility Acquisition Process

We wish to encourage the consolidation of small water utilities through acquisition because this can result in real benefits to small utilities' customers. Many small utilities lack the financial

resources or access to capital needed for capital replacements. Allowing such companies to be consolidated into larger companies or combined with other systems of smaller companies can solve such problems. Because of this we do not believe unnecessary regulatory burdens should be imposed on utilities seeking to purchase smaller water systems. To alleviate the regulatory burden that currently exists for utilities seeking to purchase smaller systems we institute the following policy:

In instances where a Class A, B, or C water utility that is in good standing with the Commission, ADEQ and ADWR seeks to purchase a class D or E water utility and absent extraordinary circumstances, when the acquiring utility requests a waiver under A.A.C. R14-2-806 of A.A.C. R14-2-803 for such a transaction, the Commission will strongly consider allowing the waiver to take effect by operation of law under A.A.C. R14-2-806(C). The waiver application must comply with A.A.C. R14-2-806(B) but need not include the information specified in A.A.C. R14-2-803(A).

We direct the Commission staff to commence a rulemaking to consider the following amendment to A.A.C. R14-2-803: "D. A notice of intent under this section is not required when the reorganization of an existing Arizona water or wastewater public utility holding company is due to the purchase of the shares (or merger of) a Class D or E water or wastewater utility".

Policy Statement No. 5
Consolidation of Small Water Utilities

It has essentially become a truism in Arizona that consolidation of small water utilities is desirable. While we do not believe that consolidation is a panacea, there can be no doubt that in some circumstances consolidating small systems into larger entities will have real benefits for customers. Consolidating systems can allow for greater and less expensive access to capital, more professional management, an ability to diversify against business risks and flexibility with rate design. The Commission Staff, RUCO and other customer advocates, industry representatives and the Commission itself have all stated that consolidation in the water industry is desirable. As such,

we believe providing explicit policy guidance is appropriate. Therefore, we adopt the following statements of policy:

1. Policy Regarding Rate Consolidation for Small Jointly Owned Water Utilities: Small Utilities in rural areas have largely been treated as stand-alone entities by the Commission for ratemaking purposes. Traditionally, a strict interpretation of the "cost user pays" principle has inhibited small water systems that do not share common facilities from consolidating rate designs. As a general policy, the Commission believes that the practical benefits from allowing rate consolidation involving small water and wastewater utilities far outweigh the benefits of a strict adherence to this theoretical principle.

Therefore, the Commission generally encourages and is in favor of allowing jointly owned Class D and E water and wastewater utilities to adopt a single rate design and/or merge into a single entity. This applies to both jointly owned Class D and E water and wastewater utilities as well as Class D and E water and wastewater utilities owned by larger classes of utilities. The Commission makes no comment here as to the general policy of consolidation that does not involve Class D and E water and wastewater utilities.

In light of these views, the Commission will generally favor proposals (brought forward in rate cases) to consolidate the rates of cases involving Class D and E water and wastewater utilities. The Commission directs Staff to evaluate the merits of such considerations. As always, the specific facts of each rate case will be considered on a case by case basis, allowing for Commission discretion, required administrative procedures, and the legal rights of participants. Therefore, in the event that specific *factual* circumstances exist that draw the benefits of rate consolidation into question, those circumstances should be fully considered.

2. Policy Regarding Direct Incentives for Acquisitions: Allowing for some form of acquisition premium associated with the purchase of small non-viable water utilities is a concept that has long been discussed favorably in Arizona but that has seen little (if any) actual adoption. We support the notion that the purchase of non-viable Class D and E water utilities should be encouraged through incentives. Therefore we endorse the following statement of Policy:

To encourage the consolidation of small water utilities, it is the policy of the Commission that acquisition premiums should be allowed for acquisitions of private water systems subject to the following conditions:

a. The acquisition serves the general public interest;

b. The acquiring utility meets the criteria of viability that will not be impaired by the acquisition; that it maintains the managerial, technical and financial capabilities to safely and adequately operate the acquired system, and is currently in compliance with all Arizona Department of Environmental Quality, Arizona Department of Water Resources, and Arizona Corporation Commission rules and orders; and will be able to meet other requisite regulatory requirements on a short and long-term basis;

c. The acquired system is classified as a Class D or E water utility; the acquired system is not viable; it is in violation of statutory or regulatory standards concerning the safety, adequacy, efficiency or reasonableness of service and facilities; or that it has failed to comply, within a reasonable period of time, with any order of the Arizona Department of Environmental Quality or the Commission;

d. Neither the acquiring nor the selling system is an affiliated interest of the other;

e. The rates charged by the acquiring system to the acquired customers will not increase unreasonably because of the acquisition;

e. The purchase price is fair and reasonable and conducted through arms' length negotiations;

g. If appropriate, the acquirer's rates may be applied to the acquired system. Under certain circumstances of extreme differences in rates, or of affordability concerns, consideration should be given to a phase-in of the rate difference over a reasonable period of time;

h. The acquisition premium must be associated with improvements, that are completed within a reasonable period of time, which can be qualitative or

quantitative or both (this provision ensures that only companies in need of improvements will be eligible for acquisition premiums); and

i. The premium must be reviewed and approved in a rate case.

It is the policy of the Commission that the acquisition premium be determined in accordance with the following principles (in addition to those above):

a. One or more of the following may be used to provide recovery of the acquisition premium:

1. A premium on the return on equity.
2. An acquisition adjustment (credit or debit adjustments to rate base for purchase price discounts or premiums, respectively, may be used).
3. A deferral of the cost of improvements the acquirer undertakes.
4. A surcharge for the recovery of the cost of improvements the acquirer undertakes.

b. If the improvements that are required to improve service quality would result in rates that are deemed too high to be absorbed by ratepayers at one time, rate recovery of the improvement costs may be recovered in phases. There may be a one-time treatment of the improvement costs in the initial rate case but a phasing in of the acquisition improvements and associated carrying costs may be allowed over a finite period.

Policy Statement No. 6
Policy Regarding the Acquisition of Viable Systems

Above we stated our clear endorsement of the use of acquisition incentives for small water utilities in need of improvement. The above policy statement applies only to the acquisition of small systems in need of improvement. The industry representatives before us have advocated adoption of the acquisition policies used in Pennsylvania which include incentives for purchase of both viable and non-viable systems. We support the notion that the purchase of non-viable Class D and E water utilities should be encouraged through incentives, including those listed above.

Given that only two such instances have occurred in the last 17 years (Decision Nos. 61307 and 63584), the Commission believes that an alternative approach may be necessary to incentivize viable water systems to purchase non-viable systems. Therefore, we endorse the following statement of policy:

1. Encourage consolidation of viable utilities: To encourage the consolidation of small water utilities, it is the policy of the Commission that acquisition premiums should be allowed for acquisitions of viable private water systems that have a demonstrated record of acquiring and improving the service provided to the customers of non-viable water systems. The allowance of additional rate of return basis points may be awarded based on sufficient supporting data submitted by the utility within its rate case filing.

Further, these acquisition premiums are subject to the following conditions:

a. The acquisition serves the general public interest;

b. The acquiring utility meets the criteria of viability that will not be impaired by the acquisition; that it maintains the managerial, technical and financial capabilities to safely and adequately operate the acquired system, and is currently in compliance with all Arizona Department of Environmental Quality, Arizona Department of Water Resources, and Arizona Corporation Commission rules and orders; and will be able to meet other requisite regulatory requirements on a short and long-term basis;

c. Neither the acquiring nor the selling system is an affiliated interest of the other;

d. The rates charged by the acquiring system to the acquired customers will not increase unreasonably because of the acquisition;

e. The purchase price is fair and reasonable and conducted through arms' length negotiations;

f. If appropriate, the acquirer's rates may be applied to the acquired system;

g. The acquisition premium must be associated with improvements, which can be qualitative or quantitative or both (this provision ensures that only companies in need of improvements will be able eligible for acquisition premiums), and

h. The premium must be reviewed and approved in a rate case.

2. Determination of acquisitions premium: It is the policy of the Commission that the acquisition premium be determined in accordance with the following principles (in addition to those above):

a. The premium should not exceed twenty percent of the original cost rate base at the time of the acquisition.

b. One or more of the following may be used to provide recovery of the acquisition premium:

1. A premium on the return on equity.

2. An acquisition adjustment (credit or debit adjustments to rate base for purchase price discounts or premiums, respectively, may be used).

3. A deferral of the cost of improvements the acquirer undertakes.

4. A surcharge for the recovery of the cost of improvements the acquirer undertakes.

c. If the improvements that are required to improve service quality would result in rates that are deemed too high to be absorbed by ratepayers at one time, rate recovery of the improvement costs may be recovered in phases. There may be a one-time treatment of the improvement costs in the initial rate case but a phasing in of the acquisition improvements and associated carrying costs may be allowed over a finite period.

Prior to the Commission implementing the "Policy Regarding Direct Incentives for Acquisitions" or the "Policy Regarding the Acquisition of Viable Systems," the Commission directs Commission Staff to collaborate with the Residential Utility Consumer Office, the Water Utilities Association of Arizona, and the Rural Water Association of Arizona to determine the

definitions of "viable" and "non-viable." Further, this group shall evaluate and define "a demonstrated record of acquiring and improving the service provided to the customers of non-viable water systems" and couple those metrics with recommended ROE adders. Commission Staff is to report back to the Commission with their findings and recommendations by September 1, 2016.

Attachment A

Questions and Proposals for the Short Form Water Rate Application

Existing Short Form Application Page 1 Water Rate Application Checklist

1. Item 1 indicates 13 copies are necessary but we understand that Docket Control actually requires 15 copies. Also, at the June 14th Staff Meeting we decided to reduce the number of copies needed. The application should be updated to reflect the actual number of copies required.
2. Items #3 and # 10 ask for the same things, ADEQ MAP invoices.
3. Item #4 is not included in the packet that applicants are required to file three copies of. We understand that some utilities are asked to file three copies of this information. The application should state that 3 copies of #4 are necessary if that is the case. It is unclear why three copies of expense invoices are necessary (items #5 to #11) but only one copy of plant invoice (item #4) is OK.
4. Why are three copies of the items included in #5-#11 necessary? Staff should determine if one copy is sufficient and whether this information can be provided electronically.
5. Item #5 requires employee names to be provided with their salaries. Is this a privacy issue?
6. Item #7 appears to be burdensome. This item requests all power invoices even though some of these can be as low as $25. Would a GL transaction list and a selection of large invoices from each account be sufficient?
7. Item #8 appears to be burdensome. It requires that all repair invoices be filed regardless of how small they are. Repair invoices can be as low as $5 for parts purchased from a hardware store. Should there be some consideration of materiality here?

Existing Short Form Application Page 2

Here the utilities are required to mail out notice on the *same* day as the rate case is docketed. For a utility with a small staff this can be a burden. Would requiring notice to be sent within a few days of the application being filed work just as well?

Existing Short Form Application Page 8

The instructions on Page 8 will need to be updated to include whatever rate design policies are adopted as part of the ongoing docket.

Existing Short Form Application Pages 10 and 11

Should the standard rates that Staff recommends for the service charges and service line and meter installation charges be included here?

Existing Short Form Application Pages 14

It may be appropriate to add a column for annual depreciation to the Plant Additions and Retirements by Year Schedule. The annual depreciation is usually asked for through data requests so why not just ask for it up front in the application?

Existing Short Form Application Page 20

The income statement schedule doesn't provide a way to show pro forma adjustments and it doesn't include a column for income at proposed rates. Should these be included?

Existing Short Form Application Page 21

Income taxes for LLCs: an example of how this works would be helpful.

Existing Short Form Application Page 22

The Depreciation Expense Form doesn't include a way to calculate depreciation expense at proposed rates. That is, there is no true up for the half year convention for plant added in the test year.

Existing Short Form Application Page 27

Splitting out LXA AIAC and Meter deposit AIAC will make things simpler in the long run. When they are tracked and reported jointly as required here it can lead to confusion and data requests (especially if there is a lot of both types of AIAC.) It may be worthwhile to have the two types of AIAC reported separately on this schedule.

Existing Short Form Application Page 28

This CIAC schedule doesn't include CIAC Amortization. But the amortization is asked for through data requests. Why not include it in the application?

Existing Short Form Application Pages 30 to 34

The quarterly breakout of the bill count is unnecessary and creates more work for little if any benefit. The quarterly break out seems to be a vestige from when bill counts were done manually. Today, even the smallest utilities keep their billing records electronically. It should be made clear that the quarterly break out is optional and necessary only for utilities that do not have electronic billing systems and/or for use by utilities that are having trouble getting their bill count to tie out to revenue.

Short Form for Wastewater:

Should there be a short form application for wastewater? Currently some wastewater utilities use a modified version of the water short form that they create themselves. Should we continue that practice or should we create a formal short form for wastewater?

ATTACHMENT NO. 2

Commission Policy Statements for Small Water System Emergencies proposed by Commissioner Tobin and as modified, adopted and approved by the Commission at its June 24, 2016 Open Meeting

Introduction

Arizona and the rest of the American Southwest are in the midst of 21-year drought with no relief in sight.[1] According to a recent study by researchers from the National Center for Atmospheric Research, weather systems bringing moisture to the Southwest are becoming rarer, and the new normal in the region "is now drier than it once was."[2] Another study concluded that the chances of a "megadrought," or a drought lasing 35 years or more, are between 20 and 50 percent.[3]

Extremely dry weather has converged with the long-known over allocation of Colorado River water supplies. Since the early 2000s, water levels at Lake Mead, where river water is stored for Arizona, California, Nevada, and Mexico, have declined by as much as 12 feet a year.[4] The Bureau of Reclamation projected last month that the water level at Lake Mead by year's end will be just three feet above the 1,075-foot shortage declaration level that would trigger significant reductions in water deliveries to all states except California. For comparison, Lake Mead was approximately seven feet above the trigger level at the beginning of 2016.

This longer term trend has made way for a potential tri-state water agreement between Arizona, California, and Nevada, which would result in immediate cuts in Central Arizona Project's supply of river water to all sectors of Arizona that rely upon CAP water for drinking and

[1] Drought - Arizona State Climate Office. (n.d.). Retrieved May 12, 2016, from https://azclimate.asu.edu/drought/
[2] Prein, A. F., G. J. Holland, R. M. Rasmussen, M. P. Clark, *and* M. R. Tye (2016), Running dry: The U.S. Southwest's Drift into a Drier Climate State, *Geophys. Res. Lett.*, *43*(3), 1272–1279, doi:10.1002/2015GL066727
[3] Ault, T. R., J. E. Cole, J. T. Overpeck, G. T. Pederson, D. M. Meko (2014), "Assessing the Risk of Persistent Drought Using Climate Model Simulations and Paleoclimate Data," *Journal of Climate*, *27*(20), 7529-7549, doi: 10.1175/JCLI-D-12-00282.1.
[4] Davis, T. (2016, April 23). Big CAP cuts coming as 3-state water agreement nears. *Arizona Daily Star*. Retrieved from http://www.tucson.com.

irrigation. These cuts would shift water users to local water supplies. Further, even if this pact were accepted and adopted by each party, the water levels are still projected to decline, albeit at a much slower pace. Fortunately, Arizona has led the nation in groundwater replenishment and is prepared, but that doesn't mean the state and especially small water companies are out of the woods, nor does this mitigate the reduced availability of surface water as result of prolonged drought.[5]

In addition to drought, water quality also poses a tremendous financial burden to Arizona water providers. There are currently 71 drinking water standards that the EPA mandates as part of the 1974 Safe Drinking Water Act regulations. The Environmental Protection Agency Drinking Water Infrastructure Needs Survey projects water treatment improvements to cost $72.5 billion over the next 20 years.[6] The cost of cleaning water will have an especially acute impact on smaller water providers given the limited customer base to pay for expensive water treatment technologies.

Simply put, Arizona faces a sobering water future: "The end of the 'cheap water' era....[and the beginning] of a world in which water is more scare, more valuable, and more expensive."[7] CAP shortages will entail increased reliance on local water supplies, undoubtedly affecting the aquifers many small, rural water companies rely upon to sustain the communities they serve. The cost curve to operate a water system will bend significantly upward as wells will need to be drilled deeper and pumps will need to be larger and more powerful. Looming infrastructure investments to combat drier conditions and new environmental regulations, replace crumbling pipes, and upgrade the capacity of systems to reflect population growth will require

[5] Arizona Department of Water Resources. (2014). Arizona's Next Century: A Strategic Vision for Water Supply Sustainability. p. 14.
[6] U.S. Environmental Protection Agency: Office of Water. (2013). Drinking Water Infrastructure Needs Survey and Assessment Fifth Report to Congress. EPA 816-R-13-006, Washington DC 20460.
[7] Quinn, P., P. Walker (2014). The Challenges of Consolidating an Industry. p. 19. Docket No. WS-00000A-14-0198.

highly sophisticated managerial, fiscal, and technical prowess. This paradigm shift will cause many small water companies to become troubled and many troubled small water companies to fail.

In a good number of cases, consolidation might provide the best hope for a financially sustainable water company that offers superior service to the public at reasonable rates. Chairman Little's workshop revisits this sticky wicket that has wracked the Commission since 1998—at least that is how far recent memory reaches back. The Water Task Force convened by then-Chairman Jim Irvin, provided a blue print of policy guidance for Commission Staff to pursue over the next decade.[8] In 2010, the Commission investigated other mechanisms that could encourage the acquisition of troubled water companies and ultimately adopted a policy statement that provided guidance to Commission Staff regarding treatment of income tax expenses for tax pass-through entities.[9] Former Chairman Susan Bitter Smith reopened the consolidation discussion in 2014, which generated many ideas that are before the Commission today.

Missing in 1998, 2010, and 2014 is a clearer acknowledgment that, in certain cases, consolidation will either not be a feasible concept for some troubled companies or that it will occur after the troubled company fails. What should be the Commission's response in those instances? The attached policy statements seek to answer that question in part. Below is a summary of each statement.

Water Emergency Team

Policy Statement No. 1 addresses the recently established Water Emergency Team (WET). On April 25, 2016, a group of representatives from state government and the water industry met to discuss the formation of a WET and other challenges plaguing small water systems. The group met again on May 5th and May 12th. These meetings were predicated on the water emergency of

[8] Decision No. 62993 (November 3, 2000). Docket No. W-00000C-98-0153.
[9] Decision No. 73739 (February 22, 2013). Docket No. W-00000C-06-0149.

the Citrus Park Water Company in Tacna, AZ. The community lost water service after the water table dropped due to nearby irrigation. Because of the efforts of the company's Interim Manager (IM), Nancy Miller, and other private citizens, along with Yuma County Supervisor Russ Clark, Commission Staff, and the Department of Environmental Quality, limited water services were restored nearly a week later.

Citrus Park is a tragic story that has come to define the purpose of WET and the vision of where the state should be in terms of immediate-, short-, and long-term policymaking for small water companies. The failure of Citrus Park might be attributed to a variety of factors including system abandonment by the owner several years ago (which has yet to be resolved), mechanical problems with the well pumps, and environmental realities of more stringent water quality regulations coupled with reduced local water supply.

Citrus Park revealed serious gaps in what should be a coordinated approach to an emergent water crisis. We learned that there were no clear protocols on which organization would lead the state's response, including a determination of whether an emergency existed, a health and welfare check of the residents affected, an engineering visit to the system to classify the severity of the problem, the communication with nearby water providers to help restart service, or an evaluation of emergency rates or other options, like interconnections with nearby systems, as viable actions to resume water service.

The simple question of, "Who picks up the phone when emergency strikes?" was surprisingly difficult to answer at the initial WET meeting.

WET is designed to provide greater coordination among state agencies and industry officials in cases where a water emergency (e.g., a water outage or contamination of water in excess of environmental standards) poses an imminent threat to public health and safety. This goal

was discussed by the Regulatory Reform Subcommittee of the 1998 Water Taskforce but no action was taken at that time.[10] Policy Statement No. 1 defines WET, formalizes the Commission's participation in the team, and gives guidance to Commission Staff on how to interact with it.

Simplifying Regulatory Burdens on Class D and E Utilities

Policy Statement No. 2 addresses the need of Commission Staff to engage small water systems as soon as practicable and educate them on the purpose and importance of compliance items, such as the annual reports, and provide easy-to-follow steps (and one-on-one guidance if needed) on how to fulfill these regulatory obligations.

But this policy statement goes further. The Commission directs Staff to work with the Residential Utility Consumer Office (RUCO), the Water Utilities Association of Arizona and the Rural Water Association of Arizona to evaluate adopting less burdensome regulations for Class D and E water companies. Commission Staff should focus on simplifying the rate case process and annual reporting requirements. One reform might be reducing the rate case time frame to 90 days for Class D and E water companies.

Establishing a Commission Ombudsman for Small Water Companies

Policy Statement No. 3 establishes a Commission Ombudsman. Both RUCO and Arizonans for Responsible Water Policy included this recommendation in their May 8, 2014 white paper because "many small water companies have demonstrated very significant challenges interpreting and navigating the Corporation Commission's rate case process."[11]

Policy Statement No. 3 directs the Executive Director to produce a proposal using existing Commission resources that would establish and fill the Small Water Ombudsman office with the

[10] Residential Utility Consumer Office (1999) [Appendix]. In Arizona Corporation Commission, *Interim Report of the Arizona Corporation Commission's Water Task Force.* (p 18). Docket No. W-00000C-98-0153.
[11] Quinn, P., P. Walker (2014). The Challenges of Consolidating an Industry. p. 23. Docket No. WS-00000A-14-0198.

necessary staff to assist small companies with various Commission processes and conduct extensive outreach with small water companies, especially companies that have had their Certificates of Convenience and Necessity revoked.

Policy Statement No. 1
Water Emergency Team

1. The Commission officially recognizes the collaborative working group, established by the Arizona Department of Environmental Quality and known as the Water Emergency Team (WET) that is designed to develop protocols and potential regulatory and statutory changes that will provide immediate, short-term, and long-term relief to troubled water providers.

2. The Commission is aware that WET has defined "emergency" to mean an imminent threat to public health and safety, which includes an outage of water service and water contamination in excess of maximum contaminant levels as promulgated and/or implemented by the Arizona Department of Environmental Quality.

3. The Commission is aware of the following organizations participating in WET and expects additional organizations to be added as needed:

   a. Arizona Department of Environmental Quality;

   b. Arizona Department of Water Resources;

   c. Arizona Water Infrastructure Finance Authority;

   d. The Department of Emergency and Military Affairs;

   e. Arizona Commerce Authority;

   f. Arizona County Supervisors Association;

   g. Water Utilities Association of Arizona; and

   h. Rural Water Association of Arizona.

4. The Commission directs Commission Staff including the Utilities Division Director, or designee to participate fully in WET.

5. In order to strengthen the relationship between the Commission and WET, the Commission shall designate a sitting Commissioner to be a liaison to WET with the eventual goal of the Commission annually considering a Commissioner designee.

6. If any rulemaking is necessary for the Commission to fully participate in and share information with WET, then the Commission directs Commission Staff to initiate a rulemaking to adopt rules to implement this policy.

Policy Statement No. 2
Simplifying Regulatory Burden on Small Water Companies

1. The Commission directs Commission Staff to collaborate with the Residential Utility Consumer Office, the Water Utilities Association of Arizona and the Rural Water Association of Arizona to evaluate a simpler and more streamlined Annual Report for all Class D and E water utilities. The Commission further directs Commission Staff to report back to the Commission with an appropriate recommendation by September 30, 2016.

2. The Commission directs Commission Staff to collaborate with the Residential Utility Consumer Office, the Water Utilities Association of Arizona and the Rural Water Association of Arizona to evaluate simpler and more streamlined rate and financing case processes for all Class D and E water utilities. The Commission further directs Commission Staff to report back to the Commission with an appropriate recommendation by September 30, 2016.

Policy Statement No. 3
Creation of Commission Small Water Ombudsman Office

1. The Commission directs the Executive Director to create within the Utilities Division a Small Water Ombudsman Office, consisting of an accountant, consumer services representative,

and engineer, for all Class D and E utilities to assist these companies in preparing and filing rate and financing applications, along with other compliance filings, as well as help evaluate long-term planning in infrastructure, acquisition, etc.

2. The Commission encourages the Small Water Ombudsman Office to conduct outreach as soon as practicable to small water companies in operation that have had their Certificates of Convenience and Necessity canceled or that are out of compliance with the Arizona Department of Environmental Quality or the Arizona Department of Water Resources.

3. The Commission directs Commission Staff to report back to the Commission by the October 2016 Open Meeting on the status of these companies and necessary action plans for these companies to resolve compliance issues.

4. The Commission directs Commission Staff to initiate a rulemaking to adopt rules, if necessary, to implement this policy.

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July 15, 2016

I would like to take this opportunity to congratulate my fellow Commissioners, Commission Staff, RUCO and all the representatives from the water industry who contributed to making this Decision possible. All of these parties made positive contributions to the Decision. I look forward to continuing the work laid out in this Decision and believe that the continued collaboration of the parties involved will lead to significant positive change.

During the June 24, 2016 Open Meeting several amendments to the Statement of Policy document I docketed on June 21, 2016 were proposed and adopted. I supported these amendments and believe they enhanced the overall quality of the document. The Commission Staff has done an exemplary job of incorporating the language of those amendments into the Statement of Policy document. However, I believe two of the amendments slightly changed and/or clouded the meaning of the document inadvertently, and I am taking this opportunity to clarify my understanding of the document's meaning.

Commissioner Tobin's Amendment No. 1 replaced the process for disbursements from the Small Water System Fund I had laid out with a more detailed process. I supported and continue to support the adoption of Commissioner Tobin's alternate language. However, after incorporating the language from the amendment we adopted, the final policy document now states "...we adopt a modified version of the process outlined below:" (at page 7 line 12 of the final policy statement attached to this Decision.) To be clear, I do not believe it was the Commission's intent to adopt a "modified version" of what follows, we were adopting the process as written. (The word "modified" is a holdover from the original version where I described my process as a modified version of what Staff had provided in 2015.)

Commissioner Tobin's Amendment No. 2 made changes to the Emergency Surcharge policy I proposed. My original language provided that a write up on the process for applying for an emergency surcharge shall be posted on the Commission's web page so that small water utilities would know and understand the process. The revised language (at page 4 starting at line 13 of the final policy statement attached to this Decision) requires Staff to develop two alternative processes but it does not require that a write up on the process adopted be made available on the Commission's web site. I believe this was inadvertent. There is significant value in making the process description available to the small water utilities we regulate and I still expect that the process we ultimately adopt will be posted on the Commission's web page.

Sincerely,