

ORIGINAL

EXCEPTION



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BEFORE THE ARIZONA CORPORATION COMMISSION

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OFFICE OF THE SECRETARY

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8 IN THE MATTER OF THE APPLICATION
 9 ARIZONA WATER COMPANY, AN
 10 ARIZONA CORPORATION, FOR
 11 ADJUSTMENTS TO ITS RATES AND
 12 CHARGES FOR UTILITY SERVICE
 13 FURNISHED BY ITS EASTERN GROUP
 14 AND FOR CERTAIN RELATED
 15 APPROVAL.

DOCKET NO. W-01445A-02-0619

Arizona Corporation Commission

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EXCEPTIONS OF THE RESIDENTIAL UTILITY CONSUMER OFFICE

13 The Residential Utility Consumer Office ("RUCO") makes the following Exceptions
 14 to the Recommended Opinion and Order ("ROO") on the Eastern Group of Arizona Water
 15 Company's ("Arizona Water" or "Company") application for a rate increase.
 16

17 On January 2, 2004, the Administrative Law Judge ("ALJ") issued his ROO. RUCO
 18 does not take exception to the overall result¹ arrived at by the ALJ in the ROO. However,
 19 RUCO recognizes that the ROO is subject to amendment, and therefore, in order to
 20 preserve its arguments, RUCO makes the following Exceptions.

21 _____
 22 ¹ There is an inconsistency between the basis of the ROO's recommended rate base and recommended
 23 operating income. The recommended rate base is based on the Company's rejoinder rate base net of the
 24 ROO's adjustments. The recommended operating income, however, is based on the Company's rebuttal
 operating income net of the ROO's adjustments. The operating figures presented on the ROO's Exhibit B
 should be updated to reflect the Company's rejoinder position. Attached hereto as Exhibit A is a corrected
 Exhibit B.

1 **THE REVENUE REQUIREMENT**

2 The ROO adopts the Company's methodology for ascertaining its revenue
3 requirement. In so doing, the ROO disregards the requirement of A.A.C. R14-2-103 (B)
4 that rate applications be based on a historical test year. The ROO adopted the Company's
5 proposal which compared the balances of the Company's revenues, expenses, and
6 ratebase elements for the historical test year (2001) with estimated post-test year 2002
7 revenues, expenses and ratebase elements.

8 RUCO has consistently opposed the consideration of rate case elements outside of
9 the historical test year. Transcript, Vol. IV at 723. RUCO has maintained, and still
10 believes that the inclusion of pro-forma rate case elements violates the matching principle,
11 the used and useful principle, and the use of the historic test year requirement. RUCO
12 recognizes, however, and respects the Commission's decisions to allow post-test year
13 plant in certain circumstances. In the present case, RUCO recommends that should the
14 Commission consider the Company's request to include select post-test-year plant, it
15 consider the actual post-test year expenses, revenues and plant. Transcript, Vol. IV at
16 724. Here, the situation is unique in that a 105-day extension allowed RUCO the time to
17 collect and analyze the Company's operating results for the Company's full 2002 operating
18 period. R-3 at 16. Thus, RUCO was able to consider the actual figures, which are seldom
19 known when considering post-test year rate case elements. The actual figures that RUCO
20 used were factual, truthful, based on unbiased information and do not favor one set of
21 interested parties such as shareholders and/or ratepayers. Id. Moreover, the actual
22 figures are the most current information available that is known and measurable and when
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24

1 used to adjust the historical test year figures, adheres to the most fundamental accounting
2 rules and principles. Id.

3 The Company's failure to match all the rate base elements results in an
4 overstatement of its revenue requirement. The Company failed to properly match the post-
5 test year CIAC, AIAC, accumulated depreciation and accumulated deferred income tax
6 ("ADIT") with its post-test year plant. CIAC, AIAC, accumulated depreciation and ADIT are
7 all reductions to rate base, thus the failure to match these items on a post-test year basis
8 results in an overstated rate base.

9 The ROO misunderstands RUCO's argument on this point. According to the ROO,
10 the evidence does not support RUCO's contention that the post-test year plant was
11 financed by CIAC or AIAC and that a mismatch results because the post-test year plant
12 was financed with CIAC. ROO at 4, 5. RUCO never made this contention. The ROO
13 correctly notes that according to the Company, the Company did not request any post-test
14 plant that was supported by CIAC, and accordingly, the Company has not mismatched its
15 requested post-test year plant additions.

16 RUCO is aware that the portion of post test-year plant request by the Company is
17 not supported by CIAC. RUCO's argument is far broader than represented in the ROO,
18 and hinges on the Company's failure to properly match all rate base elements (plant,
19 accumulated depreciation, CIAC, AIAC, and ADIT). RUCO's proposed adjustments do not
20 look at just a few selected post-test year rate base elements, as does the Company, but
21 rather includes all of the 2002 rate base balances. Only by including all 2002 rate base
22 balances is proper matching achieved.

1 As can be seen by comparing the Company's 2001 and 2002 actual rate case
2 elements to the Company's estimated pro-forma rate case elements, the mismatch caused
3 by estimating and selectively picking and choosing which elements to state on a post-test
4 year basis has resulted in a substantial overstatement of the Company's ratebase and net
5 income figures. See Exhibit B (R-9). The Commission should reject the Company's use of
6 pro-forma estimates and amend the ROO to properly characterize RUCO's position
7 regarding the proper matching of all post-test year ratemaking elements.

8
9 **INCOME TAX LAG DAYS**

10 The issue here centers on what is the proper calculation of the Company's federal
11 tax lag. The Company's proposed calculation assumes monthly federal income tax
12 payments because the Company records the expense on a monthly basis. RUCO
13 contends that the Company's federal tax lag calculation is incorrect because the Company
14 pays the taxes on a quarterly basis and the lag calculation should be made based on when
15 the Company pays the tax, not records it. RUCO-5 at 26-27.

16 The ROO adopted the Company's lead-lag position based on the Company's
17 testimony that RUCO's calculations relied on the "erroneous assumption that income tax
18 payments are made on an annual basis." ROO at 9, A-13 at 20. Unfortunately, it was the
19 ROO that relied on the erroneous assumption of the Company that RUCO's calculations
20 were based on annual tax payments. RUCO argued, and still maintains that the
21 Company's tax payments were made on a quarterly basis, not an annual basis. Since the
22 purpose of the lead-lag calculations are to measure cash working capital, the calculations
23 should be based on the Company's quarterly tax payments, not when the expense is
24

1 recorded on the Company's books, as recommended in the ROO. The Commission
2 should reject the ROO's recommended federal income tax lead-lag calculation.

4 **CONSOLIDATION OF APACHE JUNCTION AND SUPERIOR SYSTEMS**

5 The ROO recommends that the Superior and Apache Junction systems should be
6 consolidated for rate-making purposes under the Company's proposed two-step process.
7 ROO at 28. The ROO distinguishes this case from the Company's recent northern division
8 rate case where the Commission ruled against Consolidation. Decision No. 66400,
9 decided on October 14, 2003. According to the ROO, this case is different in that full
10 interconnection of the Apache Junction System with the Superior System will be completed
11 in less than two years and thus, interconnection is not speculative but imminent. ROO at
12 28.

13 The distinction noted in the ROO is not relevant and should not serve as the basis
14 for the Commission to change its position regarding consolidation. At the present time,
15 which is what is under consideration for ratemaking purposes, the cost of service to
16 Superior is based on its stand-alone operations, i.e. – not being connected with Apache
17 Junction. Similarly, Apache Junction's cost of service is based on its stand-alone
18 operations. The fact that at some point in the future the two systems will be
19 interconnected has absolutely no effect on each systems current cost of service. Neither
20 the ROO nor the Company has pointed to one valid reason why consolidation should occur
21 when currently the two systems' do not share a common cost of service. When there is
22 interconnection, whenever that may be, the Company can then come before this
23 Commission and request consolidation.

1 Moreover, the Company's recommendation is inconsistent with the Commission's
2 directive to the Company in Decision Nos. 5810, 64282 and most recently 66400 to
3 preserve individual system data and rates. In Decision No. 66400, the Commission
4 considered the Company's request to consolidate its Sedona, Pinewood and Rimrock
5 systems and its Overgaard and Lakeside systems. In that case, the Company was
6 proposing a two-step consolidation process in anticipation of the significant costs expected
7 to be incurred for the treatment of arsenic to achieve compliance with the EPA
8 requirements. Decision No. 66400 at 11. In its Decision, the Commission noted that non-
9 consolidation will more accurately reflect a proper allocation of costs to the systems that
10 caused the Company to incur such costs. The Commission was very concerned that the
11 individual identity of each of the systems was maintained for ratemaking purposes. Id. at
12 12-13. This same concern outweighs the possibility of any efficiency that may result from
13 consolidation prior to interconnection. The Commission should reject the ROO's proposal
14 to consolidate the Apache Junction and Superior systems.

15
16 **CONCLUSION**

17 RUCO recommends that the Commission adopt the ratemaking figures
18 recommended in the ROO. Should the Commission consider larger figures, RUCO
19 recommends that the Commission reject the Company's proposal to use pro-forma
20 estimates and only consider pro-forma figures to the extent they are actual amounts and
21 properly matched. The Commission should amend the ROO to correctly state RUCO's
22 position regarding the inclusion of AIAC and CIAC in the post-test year adjustments. The
23 Commission should further approve RUCO's recommendation to calculate the lead lag for
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1 federal income taxes based on its actual quarterly payment schedule and should not
2 approve consolidation of the Apache Junction and Superior systems.

3 RESPECTFULLY SUBMITTED this 21st day of January, 2004

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7 _____
8 Daniel W. Pozefsky
9 Attorney

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16
17 By Cheryl Braulob
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EXHIBIT A

RUCC CORRECTED EXHIBIT B
OPERATING STATEMENT

LINE NO.	DESCRIPTION	Apache Junction	Bisbee	Miami	Oracle	San Manuel	Sierra Vista	Superior	Winkelman	Eastern Group
1	Company Test Year Operating Income - Rejoinder	\$ 1,885,563	\$ 29,073	\$ 92,973	\$ 158,185	\$ (181,279)	\$ 31,373	\$ (4,800)	\$ 8,419	\$ 2,019,507
2	Adjustment to Revenue	-	(347)	-	-	-	-	-	-	(347)
3	Adjustments to Purchased Water	5,747	-	-	916	(7,875)	-	-	-	(1,212)
4	Adjustments to Purchased Power	6,251	3,783	40,123	-	1,024	2,544	-	122	53,847
5	Adjustments to Water Treatment Expense	(5,320)	6,143	62,992	(9,014)	9,269	5,031	8,847	(242)	77,706
6	Adjustments to Transmission/Distrib. Exp.	19,050	4,261	3,788	1,724	1,981	(4)	1,639	237	32,676
7	Adj. to Customer Account Expense	(225)	3	1	(5)	1	(4)	4	2	(223)
8	Adj. to Administrative/General Expense	33,499	7,460	2,030	977	830	1,372	943	116	47,227
9	Adj. to Depreciation/Amortization	337,635	5,632	42,131	1,954	12,874	2,256	2,100	219	404,801
10	Adj. to Property Tax	(56,744)	5,838	(3,010)	(953)	(6,957)	5,240	(11,647)	(1,402)	(69,635)
11	Adj. to Federal/State Income Tax	(290,039)	12,348	(98,493)	(5,347)	16,847	8,133	10,404	597	(345,550)
12	ROO Test Year Adj. Operating Income	\$ 1,935,417	\$ 74,194	\$ 142,535	\$ 148,437	\$ (153,285)	\$ 55,941	\$ 7,490	\$ 8,068	\$ 2,218,797

REFERENCES:
LINE 1: COMPANY REJOINDER TESTIMONY EXHIBIT SLH-RJ3, PAGES 1 THRU 9
LINES 2 THROUGH 11: RECOMMENDED ORDER AND OPINION
LINE 12: SUM OF LINES 1 THRU 11

EXHIBIT B

ARIZONA WATER COMPANY
 EASTERN GROUP
 TEST YEAR ENDED DECEMBER 31, 2001

COMPARISON OF 2001 & 2002 ACTUALS TO COMPANY ESTIMATED PROFORMA

LINE NO.	DESCRIPTION	(A) 2001 ACTUAL	(B) 2002 ACTUAL	(C) 2002 COMPANY ESTIMATED PROFORMA
<u>REVENUES - WATER:</u>				
1	REVENUE FROM WATER SALES	\$ 15,529,177	\$ 16,866,598	\$ 14,653,118
2	OTHER REVENUES	-	-	-
3	TOTAL OPERATING REVENUES	\$ 15,529,177	\$ 16,866,598	\$ 14,653,118
<u>OPERATING EXPENSES:</u>				
4	PURCHASED WATER	\$ 940,389	\$ 1,080,683	\$ 1,261,743
5	OTHER	54,305	55,975	54,359
6	PURCHASED POWER	1,286,379	1,402,559	1,312,960
7	PURCHASED GAS	905	1,796	905
8	OTHER	405,759	493,828	405,759
9	WATER TREATMENT	329,496	372,397	438,652
10	TRANSMISSION & DISTRIBUTION	1,562,945	1,695,062	1,722,202
11	CUSTOMER ACCOUNTS	1,379,224	1,435,889	1,415,837
12	SALES	6,851	4,145	6,851
13	ADMINISTRATIVE & GENERAL	1,605,020	1,710,427	1,862,416
14	DEPRECIATION & AMORTIZATION	1,802,267	1,979,011	2,288,733
15	PROPERTY TAXES	1,081,365	1,068,382	1,232,765
16	OTHER TAXES	1,354,625	1,472,738	175,137
17	INCOME TAXES	1,099,225	1,086,045	505,764
	TOTAL OPERATING EXPENSES	\$ 12,908,755	\$ 13,858,937	\$ 12,684,083
19	NET INCOME	\$ 2,620,422	\$ 3,007,661	\$ 1,969,035
20	RATE BASE	\$ 35,182,167	\$ 36,085,391	\$ 41,604,878

REFERENCES:

COLUMN (A): RUCO DIRECT TESTIMONY - PAGE 2 OF SCHEDULES WAR-10 AND TJC-10, COLUMN (A)
 COLUMN (B): RUCO DIRECT TESTIMONY - PAGE 2 OF SCHEDULES WAR-10 AND TJC-10, COLUMN (B)
 COLUMN (C): RUCO DIRECT TESTIMONY - PAGE 1 OF SCHEDULES WAR-10 AND TJC-10, COLUMN (A)