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BEFORE THE ARIZONA CORPORATION COMMISSION

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- WILLIAM A. MUNDELL  
COMMISSIONER
- JEFF HATCH-MILLER  
COMMISSIONER
- KRISTIN K. MAYES  
COMMISSIONER
- GARY PIERCE  
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF  
THE RESIDENTIAL UTILITY CONSUMER  
OFFICE, TO REVIEW A DETERMINATION  
OBTAINED BY THE GOLD CANYON  
SEWER COMPANY FOR INCREASES IN  
ITS RATES AND CHARGES FOR UTILITY  
SERVICE BASED THEREON.

Docket No. SW-02519A-06-0015

Arizona Corporation Commission

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**REPLY TO RESPONSE TO RUCO'S MOTION TO DISAPPROVE GOLD CANYON'S  
PROPOSED REVISED RATES AND CHARGES**

The Residential Utility Consumer Office ("RUCO"), hereby replies to Gold Canyon Sewer Company's ("Gold Canyon" or the "Company") response to RUCO's motion to disapprove the Company's proposed rates and charges as set forth in the Company's Notice of Filing docketed with the Commission on November 28, 2008.

The Commission's decision on rehearing to approve a hypothetical capital structure will benefit ratepayers. The primary benefit of the hypothetical capital structure is the effect of interest associated with the cost of debt. RUCO has calculated the effect of the benefit of interest associated with debt to be a \$312,890<sup>1</sup> reduction in the revenue requirement.

<sup>1</sup> RUCO has attached a copy of its calculations hereto as Exhibit 1.

1 The Company states that Decision No. 70624 does not require the Company to  
2 implement a hypothetical capital structure. Response at 2. In fact, the Company claims that it  
3 would have had to "guess" to arrive at an interpretation which would have included the effects  
4 of interest in the revenue requirement. Id. Instead, the Company tap dances around the  
5 obvious intent of the Commission, and renders inconsequential the Commission's decision on  
6 this issue by its own dismissive interpretation of the Commission's intent. The Company's  
7 filing is absurd, disrespectful to the ratepayers and inconsistent with what the Company and  
8 the Commissioners said at the Open Meeting.

9 Decision No. 70624, provides in relevant part:

10 Resolution of Hypothetical Capital Structure Issue

11 32. We agree with RUCO's hypothetical capital structure of  
12 40 percent debt and 60 percent equity... We therefore adopt a  
13 hypothetical capital structure of 40 percent debt and 60 percent  
14 equity.

15 33. ...We believe that adoption of RUCO's recommendations  
16 results in just and reasonable rates and charges for Gold Canyon  
17 based on the record of this proceeding. We therefore adopt a cost  
18 of equity of 8.60 percent, which also results in an overall weighted  
19 cost of capital of 8.54 percent.  
20 Decision No. 70624 at 14.

21 RUCO's hypothetical capital structure recommendation included the effects of interest  
22 associated with its proposed cost of debt. Perhaps no party was more aware of this than the  
23 Company, as clearly noted in Decision No. 70624. In reciting the Company's position,  
24 Decision No. 70624 provides in relevant part:

30. The Company claims that RUCO's real motive in  
proposing a hypothetical capital structure is to lower Gold Canyon's  
operating expenses by creating a further hypothetical interest  
expense resulting from the hypothetical debt creation. According to  
the Company, after assuming Gold Canyon has hypothetical  
interest expense associated with the hypothetical debt, RUCO next  
uses the hypothetical interest to calculate the Company's federal

1 and state income tax expenses, thereby calculating a hypothetical  
2 reduced income tax obligation, and ultimately fictionally reducing  
3 the Company's actual test year operating expenses. ...Gold  
4 Canyon argues that it is only by recognizing RUCO's proposed  
5 hypothetical debt interest expense that the authorized revenue  
6 requirement would be reduced –by over \$205,000. The Company  
7 contends that RUCO's recommendation would result in an  
8 approximate 10 percent reduction of its authorized revenues, thus  
9 reducing the Company's actual authorized return on rate base to  
10 7.24 percent. (GC RH-8 at 16-17.) ...”  
11 Decision No. 70624 at 13.

12 Despite the plain language in Decision No. 70624, the Company contends that it would  
13 have had to “guess” in order to interpret the Decision to account for interest synchronization in  
14 the Company's rates. The Company's filing should be rejected and the Company should be  
15 required to file rates that include the effects of interest associated with the cost of debt.

16 The absurdity of the Company's interpretation is even more pronounced given what the  
17 Commissioner's themselves said, asked and heard at the Open Meeting. Commissioner  
18 Pierce, when explaining his vote in favor of Commissioner Mayes' amendment<sup>2</sup> stated:

19 If a company has too much equity in its capital structure, it harms  
20 ratepayers in two ways. First, it raises the cost of capital because  
21 equity is generally more expensive than debt. And, second, it  
22 deprives the company **of favorable tax implications of having  
23 debt, which ultimately inures to the benefit of the ratepayers.**  
24 Open Meeting Transcript at 185-186 attached hereto. (Emphasis  
added).

25 RUCO's counsel explained to the Commission what the effects of interest associated  
26 with the cost of debt would mean if RUCO's recommended hypothetical capital structure were  
27 adopted. Open Meeting Transcript at 55 – 56. There was no discussion at the Open Meeting

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<sup>2</sup> Commissioner Mayes' Amendment No. 2, according to Commissioner Mayes was “...the adoption of a hypothetical capital structure.” See Open Meeting Transcript at 184.

1 that challenged the notion that the consideration of interest associated with the cost of debt as  
2 RUCO was recommending would benefit ratepayers.

3 In fact, even the Company understood RUCO's recommendation to include the effects  
4 of interest associated with the cost of the debt. The Company's attorney explained to the  
5 Commission what he believed would be the effect of RUCO's recommendation:

6 MR. SHAPIRO: Yes, I had a chance to confer with Mr.  
7 Bourassa during the break, the company's regulator accountant,  
8 and had a chance to confer with RUCO. And I believe, and Mr.  
9 Pozefsky will correct me if I am wrong, but RUCO's two  
10 adjustments in total reduced the revenue increase that was  
11 awarded in the original decision from 1.8 million approximately to  
12 981,000 approximately. So that is, those two adjustments combined  
13 have an impact on the company of over \$800,000 a year of annual  
14 revenue. We can break those down a little further. And really, and,  
15 again I am going to try to use some approximates and not be exact,  
16 we can be more exact, if I understand, the impact of the excess  
17 capacity adjustment is about half of that, about \$400,000 a year.  
18 That would be the impact of return on rate base, depreciation, and  
19 then the gross-up for income taxes. RUCO's hypothetical capital  
20 structure adjustment is the remainder of that roughly 800,000 plus.  
21 And then that again could be divided down as to whether or not  
22 RUCO's rate of return was used, which puts about \$220,000 of  
23 revenue taken out, **and then the interest synchronization, which  
24 is about another \$200,000 of revenue.** Again, all in total, RUCO's  
two proposed adjustments reduce the company's revenue  
requirement from one -- increase in the revenue requirement from  
approximately 1.8 million to under \$1 million, about 980,000.  
Open Meeting Transcript at 124-125. (Emphasis added).

18 When asked by Commissioner Hatch-Miller, the Company explained that the  
19 hypothetical interest adjustment is typically a necessary and consistent part of imposing a  
20 hypothetical capital structure:

21 COM. HATCH-MILLER: And I guess what I am trying to ask,  
22 though, is the hypothetical interest adjustment a necessary and  
23 consistent part of imposing a hypothetical capital structure?

24 MR. SHAPIRO: And I think I would answer that fairly that  
typically it is. However, RUCO admitted in this case that it need not  
be.

1 COM. HATCH-MILLER: Okay. That's all I wanted to make  
2 sure.  
3 Open Meeting Transcript at 181.

4 Prior to voting, Commissioner Pierce asked RUCO's counsel to distinguish the effects of  
5 interest associated with the cost of debt from the recommendation the Commission previously  
6 had adopted.

7 COM. PIERCE: Is the Hamada adjustment designed to  
8 address these foregone tax benefits or is it focused solely on the  
9 reduced cost of equity due to the 100 percent capital structure?

10 MR. POZEFSKY: Well, yes, the Hamada method, you don't  
11 have the interest and the income tax implication with the use of the  
12 Hamada method. That's not a concern. Again it is because, well,  
13 you are using hypothetical, you are creating hypothetical debt.  
14 Open Meeting Transcript at 77.

15 Commissioner Mayes asked Staff to explain the rate impact if the Commission were to  
16 adopt her amendment. The Commission's advisor, Alexander Igwe, explained that the  
17 reduction of the rate of return to 8.54% would result in a decrease in the revenues of "...  
18 approximately \$400,000, which translates to about \$6." Open Meeting Transcript at 185. As  
19 more fully shown in Exhibit 1<sup>3</sup>, attached hereto, to get to those numbers there must have been  
20 consideration of the effects of interest associated with the cost of debt.

21 Finally, Commissioner Mundell, when explaining his vote stated:

22 COM. MUNDELL: I didn't hear you call my name. You know,  
23 from a -- first of all, I want to thank everybody that has participated.  
24 And the wheels of justice turn slowly. I know it has been a long,  
long hard process. And we voted to rehear this because we didn't  
get it right the first time. It was a three to two vote. Commissioner  
Mayes and I voted against the rate increase. And then RUCO filed  
the request for reconsideration. And that's why we are here today.  
And so, again, this is from a fairness standpoint. **This is still a**

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3 Mr. Igwe's calculation are somewhat higher than RUCOs but are close enough to assure that the effects of interest were considered. RUCO calculated that the average monthly charge for residential ratepayers (>700 square foot dwelling) will be \$4.54 less if the rates include the effect of interest associated with the cost of debt. See Exhibit 1, page 2.



1 COPIES of the foregoing hand delivered/  
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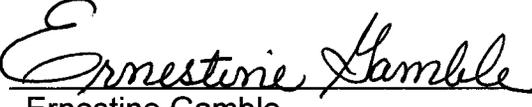
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**RUCO'S**

**EXHIBIT 1**

**COMPARISON OF COMPANY'S FILING AND RUCO CALCULATION OF DECISION NO. 70624  
REVENUE REQUIREMENT**

LINE NO.	DESCRIPTION	(A) DEC. NO. 69664 OCRB/FVRB	(B) COMPANY FILING PER DECISION NO. 70624	(C) RUCO CALCULATED APPR'D CHANGES PER DEC. NO. 70624	(D) DIFFERENCE
1	Fair Value Rate Base	\$ 15,725,787	\$ 14,725,789	\$ 14,725,789	\$ -
2	Adjusted Operating Income (Loss)	\$ 342,167	\$ 322,377	\$ 514,495	\$ 192,119
3	Current Rate Of Return (L2 / L1)	2.18%	2.19%	3.49%	1.30%
4	Required Operating Income (L5 X L1)	\$ 1,446,772	\$ 1,257,582	\$ 1,257,582	\$ -
5	Required ROR On FVRB	9.20%	8.54%	8.54%	0.00%
6	Operating Income Deficiency (L4 - L2)	\$ 1,104,605	\$ 935,206	\$ 743,087	\$ (192,119)
7	Gross Rev. Conv. (REH'G RLM-1, Pg 2)	1.6286	1.6286	1.6286	0.0000
8	Increase In Gross Rev. Req'm't (L7 X L6)	<b>\$ 1,798,999</b>	<b>\$ 1,523,108</b>	<b>\$ 1,210,218</b>	<b>\$ (312,890)</b>
9	Adjusted Test Year Revenue	\$ 2,496,380	\$ 2,496,380	\$ 2,496,380	\$ -
10	Proposed Annual Revenue (L8 + L9)	\$ 4,295,379	\$ 4,019,488	\$ 3,706,598	\$ (312,890)
11	Req'd Percentage Incr. In Rev. (L8 / L9)	72.06%	61.01%	48.48%	-12.53%
12	Rate Of Return On Common Equity	9.20%	8.60%	8.60%	0.00%

References:

- Column (A): Decision No. 69664, Pages 29 and 30
- Column (B): Difference Between Column (A) And (B)
- Column (C): Company December 1, 2008 Filing Per Decision No. 70624

Gold Canyon Sewer Company  
 Docket No. SW-02519A-06-0015  
 Test Year Ended October 31, 2005

Schedule REH'G RLM-8  
 Page 1 of 1

**COMPARISON OF COMPANY'S FILING AND RUCO CALCULATION OF DECISION NO. 70624  
 RATE DESIGN AND PROOF OF RECOMMENDED REVENUE**

LINE NO.	DESCRIPTION	(A) ORIGINAL RATES	(B) DECISION NO. 69664	(C) COMPANY FILING PER DECISION NO. 70624	(D) RUCO CALCULATED RATES & CHARGES	(E) DIFFERENCE
<b>MONTHLY FLAT RATE CHARGE</b>						
<b>CLASSES OF SERVICE</b>						
1	Residential	\$ 35.00	\$ 60.55	\$ 56.71	\$ 52.17	\$ (4.54)
2	Residential (<700 SF) Per Dwelling	\$ 19.09	\$ 33.03	\$ 30.93	\$ 28.46	\$ (2.47)
3	Residential (HOA's)	\$ 31.82	\$ 55.05	\$ 51.55	\$ 47.43	\$ (4.12)
4	Commercial, Per ADEQ Bulletin 12	\$ 0.175	\$ 0.303	\$ 0.280	\$ 0.261	\$ (0.02)
5	Effluent Sales, Per 1,000 Gallons	\$ 0.391	\$ 0.786	\$ 0.630	\$ 0.677	\$ 0.05