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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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**COMMISSIONERS**

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DOCKET NO. W-02113A-07-0551

**STAFF'S REPLY BRIEF**

**RE: REVENUE REQUIREMENT**

IN THE MATTER OF THE APPLICATION OF  
CHAPARRAL CITY WATER COMPANY,  
INC., AN ARIZONA CORPORATION, FOR A  
DETERMINATION OF THE FAIR VALUE OF  
ITS UTILITY PLANT AND PROPERTY AND  
FOR INCREASES IN ITS RATES AND  
CHARGES FOR UTILITY SERVICE BASED  
THEREON.

**I. INTRODUCTION.**

There are only a few issues remaining in dispute between Staff and CCWC. These issues include: Removal of Working Capital Components from Rate Base, the treatment of Chemical and Repairs and Maintenance Expense, Rate Case Expense, and Irrigation Rates. In addition, for the first time, CCWC is seeking a surcharge for a six-month delay in "order to ameliorate the injury due to this delay."

It is important to remember that CCWC bears the burden of proof in this case, and on these issues. CCWC has failed to meet its burden. The Commission therefore should adopt Staff's recommendations on the remaining issues in dispute as discussed below.

**II. REPLY TO CCWC'S CLOSING BRIEF.**

**A. Rate Base.**

**1. The FHSD settlement proceeds.**

Staff agrees with the Company that the settlement proceeds should be shared equally between the shareholders and ratepayers so long as the Company shares the proceeds equally with the ratepayers in the event the wells are sold.

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**2. CAP allocation.**

The Company and Staff are in agreement that the entire acquisition cost for the additional CAP allocation should be included in rate base and reclassified as a plant-in-service component of Land and Land Rights.

**3. Working capital adjustments.**

It is Staff's recommendation and position that it would be inappropriate to consider components of working capital when the Company did not prepare a lead/lag study to quantify its cash working capital. If the Company had prepared a lead/lag study, Staff would have had an opportunity to review it and make a recommendation based on it.

Staff agrees with the Company that Unamortized Debt Issuance Costs are not a part of working capital and was mistaken in stating so.<sup>1</sup> However, Staff maintains that Unamortized Debt Issuance Costs should be removed from rate base.<sup>2</sup> These costs are a below-the-line expense and should not be included in operating expenses, and should not be included in rate base.<sup>3</sup> These costs are similar to interest and are amortized over the life of the debt.<sup>4</sup> Therefore, although Unamortized Debt Issuance Costs are not part of the working capital disallowance, these costs should still be removed from rate base.

The Commission should adopt Staff's recommendation to disallow the Company's recovery of Materials & Supplies and Prepayments due to a lack of a lead/lag study. In addition, Unamortized Debt Issuance Costs do not belong in rate base and should also be disallowed.

**4. CIAC amortization rate.**

Although Staff did not address this issue in its initial closing brief, Staff offers an explanation of how Staff arrived at its CIAC amortization rate. Staff's method is shown on Revised Schedule MEM-16 (Final Schedules, Jan. 20, 2009). Staff's method computes a composite CIAC amortization rate using Depreciation Expense prior to application of the offsetting CIAC amortization as the numerator and all depreciable plant as the denominator. Staff does not include non-depreciable plant

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<sup>1</sup> Tr. at 375-76.  
<sup>2</sup> *Id.*  
<sup>3</sup> *Id.*  
<sup>4</sup> *Id.*

1 in the denominator. Staff's CIAC amortization rate calculated in Revised Schedule MEM-16 is  
2 3.57788% (\$1,773,779 / \$49,576,203). Staff believes this method is most accurate and should be  
3 adopted by the Commission.

4 **B. Income Statement Issues.**

5 **1. Property tax expense.**

6 CCWC agrees with Staff's method of calculating property tax.

7 **2. Normalization of expenses.**

8 There are two remaining issues regarding the normalization of expenses in this case. It is  
9 Staff's recommendation, and position, that it is proper to normalize the chemical expense, and the  
10 repairs and maintenance. However, as indicated in Staff's closing brief, it agrees with CCWC that  
11 there should be no adjustment to insurance expense in this case. Specifically, Mr. Bourassa, in his  
12 rejoinder testimony indicated that zero was the appropriate amount for insurance expense.<sup>5</sup>

13 CCWC in its closing brief claims that "the party proposing an adjustment to 'average'  
14 expenses should bear a heavy burden to show why the adjustment will lead to a normal or more  
15 realistic relationship between revenues, expenses and rate base."<sup>6</sup> CCWC further claims that Staff  
16 "did not identify any 'extenuating circumstances' in its testimony to justify averaging Chemicals and  
17 Repairs and Maintenance Expenses." This is incorrect. Not only did Staff address "extenuating  
18 circumstances" in testimony, but when CCWC's counsel cross-examined Staff witness Millsap on  
19 this issue he provided further explanation regarding the basis for Staff normalizing CCWC's  
20 chemical expenses.<sup>7</sup>

21 CCWC claims in its closing brief, and Staff does not disagree, that "[t]he test year is  
22 presumed to be normal, and adjustments should be made on known and measurable changes."<sup>8</sup>  
23 While this presumption may have existed initially, Staff determined there were abnormalities in the  
24 chemical expense amount that CCWC is seeking in this case. Staff discovered two abnormalities.  
25 First, Staff determined that CCWC included two rather large invoices for deliveries that took place  
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27 <sup>5</sup> Ex. A-7 at 12:18.

28 <sup>6</sup> CCWC's Closing Br. at 19:8.

<sup>7</sup> Tr. at 385:7-12.

<sup>8</sup> CCWC's Closing Br. at 19: 1.

1 late in the Test Year.<sup>9</sup> Staff concluded that these invoices were for more than monthly deliveries, and  
2 were actually for chemicals that CCWC was going to use in the following year.<sup>10</sup> Staff reduced  
3 chemical expense by that amount.

4 The other abnormality that Staff discovered is that CCWC's chemical expenses have  
5 fluctuated since 2003, the last rate case test year. During that time period, CCWC brought a  
6 treatment plant online that caused in part the fluctuation in chemical expense.<sup>11</sup> In addition, Staff  
7 looked at CCWC's chemical expense for 2007, which was less than the test year amount. Staff is  
8 recommending normalization of CCWC's chemical expenses based on all of these circumstances.  
9 CCWC admits, in its closing brief, that normalizing is a basic ratemaking principle that Staff uses,  
10 and that the Commission approved in CCWC's last case.<sup>12</sup>

11 Similarly with Repairs and Maintenance Expense, Staff based this adjustment in part on  
12 removal of the cost of beverages that CCWC provided to its employees. In addition CCWC's  
13 Repairs and Maintenance Expenses have also fluctuated since 2003.<sup>13</sup> Since there does not appear to  
14 be any upward trending in these expenses, and CCWC provided no testimony or argument to the  
15 contrary in its closing brief, the Commission should adopt Staff's recommendation to normalize these  
16 expenses.

### 17 3. Deferral of CAP M&I charges (accounting order).

18 CCWC has accepted Staff's rate base treatment of the full acquisition cost of the CAP  
19 allocation. In addition, CCWC agrees with Staff that it should be able to recover 50% of the M&I  
20 charges now and defer 50% of the charges until a later date. Where there is some disagreement  
21 between Staff and CCWC is with the language of the accounting order for the treatment of the  
22 deferred portion of the CAP M&I charges.

23 CCWC does not believe there should be a limit on the deferral period, and that the  
24 Commission should allow it to accrue reasonable carrying costs.<sup>14</sup> Specifically, CCWC asserts that  
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26 <sup>9</sup> Tr. at 384:20.

27 <sup>10</sup> Tr. at 385:1-6.

28 <sup>11</sup> Tr. at 385: 7-12.

<sup>12</sup> Ex. S-3 at 5:20; CCWC's Closing Br. at 19:5.

<sup>13</sup> Ex. S-2 at 34:4.

<sup>14</sup> CCWC's Closing Br. at 21:10-17.

1 the Commission can address these issues in a future rate case. Staff disagrees. CCWC had the  
2 opportunity to address these issues in this rate case. Staff submitted its proposed accounting order  
3 language prior to the hearing recommencing in January. Staff believes that 36 months is a reasonable  
4 time for the deferral period. Further, there is a provision in Staff's proposed accounting order  
5 language that allows CCWC to continue the deferral after evaluation in the next rate case, so it is not  
6 specifically limited to 36 months. This time period permits Staff to evaluate whether CCWC is  
7 properly accounting for the deferral, and also to determine if all or a portion of the deferred charges  
8 are used and useful, and therefore should be placed in rates. Without this mechanism, CCWC would  
9 be able to defer these charges indefinitely. Similarly, since Staff has determined that 50% of the  
10 M&I charges are not currently used and useful, CCWC should not be entitled to accrue interest on  
11 this deferral. It is also important to note that these requirements are consistent with other accounting  
12 order language approved by the Commission.

#### 13 **4. Rate case expense.**

14 There are two components to rate case expense in this case. There is the expense that CCWC  
15 incurred in the remand proceeding, and there is the rate case expense for this case. CCWC now  
16 accepts Staff's recommended level of expense for the appeal and remand equal to \$100,000.<sup>15</sup>

17 CCWC disagrees with Staff's recommendation regarding rate case expense for this case.  
18 CCWC argues in its closing brief that Staff gave no consideration to the specifics of this rate case, to  
19 the Commission's rate case process, or to the similar rate case expense awards relied upon by the  
20 Company.<sup>16</sup> This is incorrect. In Staff witness Millsap's direct testimony, he indicated that he  
21 arrived at the recommended amount of \$150,000 by reviewing the rate case expense that the  
22 Commission had approved in cases of comparably sized utilities.<sup>17</sup> CCWC seems to be under the  
23 misconception that it is entitled to recover all rate case expense no matter what the amount may be.  
24 Staff compared the amount of expense CCWC is claiming it will spend on this rate case with what  
25 the Commission has approved for other similar-sized utilities. Since CCWC only provided an  
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27 <sup>15</sup> CCWC's Closing Br. at 23:5-7.

28 <sup>16</sup> *Id.* at 24:4-7.

<sup>17</sup> Ex. S-2 at 32:4-7.

1 anticipated amount for its rate case expense, the Commission should adopt Staff's method of  
2 comparing this case to other comparably sized utilities.

3 **C. Rate Design.**

4 **1. Irrigation rates.**

5 Staff agrees that the disparity between the commodity rate for irrigation and construction  
6 water customers and other customers needs to be addressed.<sup>18</sup> Staff believes its recommended  
7 approach would be reasonable and help in promoting water conservation.

8 **2. Low income tariff.**

9 Staff recommends that the Company's proposed low income tariff be approved.

10 **3. Surcharge for delay.**

11 In its closing brief, CCWC, for the first time, requests that the Commission allow it to  
12 implement a surcharge "[i]n order to ameliorate the injury due to...delay."<sup>19</sup> CCWC further requests  
13 that the surcharge remain in effect for one year or until it recovers the necessary revenues.<sup>20</sup> The  
14 Commission should reject CCWC's request for the reason that there is nothing in the record to  
15 support it.

16 While there were delays in this case, CCWC has not demonstrated, other than by assertion in  
17 its brief, the harm that should be ameliorated. There is absolutely no testimony in the record to  
18 support the Company's contention. Delays can be common in rate cases where the issues are  
19 complex. It is certainly not something that CCWC's ratepayers should have to bear. For these  
20 reasons, Staff does not have the ability to adequately address CCWC's request, and recommends that  
21 the Commission reject CCWC's request.

22 **III. REPLY TO RUCO'S CLOSING BRIEF.**

23 **A. Treatment of CAP Water Allocation.**

24 RUCO disagrees with Staff's recommendation that 100% of the additional CAP allocation  
25 should be included in rate base. RUCO argues that (1) there is no evidence that the Company paid  
26 for the water allocation, (2) because the Company has held a 100-year Assured Water Supply

27 <sup>18</sup> CCWC's Closing Br. at 25:19-21.

28 <sup>19</sup> CCWC's Closing Br. at 27:3-4.

<sup>20</sup> *Id.* at 27:6-7.

1 Designation since the 1980s, there is no basis that the Company will be unable to meet anticipated  
2 water demands and finally, (3) the CAP allocation is not necessary to satisfy the immediate future  
3 needs of ratepayers.

4 Staff believes RUCO's arguments on the treatment of CAP water allocation are unpersuasive.  
5 In fact, Staff has found that the Company made a prudent and reasonable decision in acquiring the  
6 additional CAP allocation. First, Staff believes the Company has given sufficient evidence that the  
7 Company actually paid for the water allocation. Second, the mere fact that the Company holds a 100-  
8 year Assured Water Supply Designation does not take away from the Company's prudent decision to  
9 obtain the additional CAP water allocation. Lastly, RUCO does not use an engineering analysis to  
10 determine whether the CAP allocation is necessary to satisfy the immediate future needs of  
11 ratepayers. Instead, RUCO uses an accounting analysis with projections made by Mr. Hanford on an  
12 Arizona Department of Water Resources report as the basis for their argument. Staff, on the other  
13 hand, did perform an engineering analysis and used information submitted in the Company's annual  
14 report. Both Staff and the Company believe this is an accurate process to determine how much of the  
15 allocation is used and useful. Therefore, Staff and CCWC's recommendation should be adopted by  
16 the Commission.

17 **B. Distribution of Settlement Proceeds from Fountain Hills Sanitation District.**

18 RUCO asserts that Staff and RUCO are in agreement on the issue of the distribution of  
19 settlement proceeds from the Fountain Hills Sanitation District. However, this is not the case. Staff  
20 originally recommended that the ratepayers receive the entire amount of the settlement proceeds.  
21 Staff revised its recommendation at the hearing and now agrees with CCWC that the settlement  
22 proceeds should be shared equally between shareholders and ratepayers as long as CCWC is willing  
23 to share the proceeds from the sale of the wells.<sup>21</sup>

24 RUCO seems to believe that Marvin Millsap's testimony that he personally has not changed  
25 his opinion on the analysis of the settlement proceeds<sup>22</sup> represents that Staff has not revised its  
26 official position and recommendation to the Commission.<sup>23</sup> That is simply incorrect. Staff's

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<sup>21</sup> Staff's Closing Br. at 2-3.

28 <sup>22</sup> Tr. at 412:21-25.

<sup>23</sup> RUCO's Closing Br. at 8-10.

1 recommendation is analyzed by many different people, but the Director's Office determines the  
2 official position after considering many different factors including policy. Finally, to clear up any  
3 confusion, Staff is in agreement with CCWC that the settlement proceeds should be shared equally  
4 between shareholders and ratepayers.

5 **C. Rate Case Expense.**

6 While CCWC and Staff are in agreement regarding the expense for the appeal and remand  
7 proceeding, RUCO continues to assert the CCWC should not be entitled to receive an adjustment for  
8 the expenses CCWC incurred in the appeal and remand process. RUCO bases its position on two  
9 points. First RUCO claims, incorrectly, that Arizona law does not permit recovery of attorney's fees  
10 on remand.<sup>24</sup> RUCO cites to case law that indicates that the recovery of attorneys' fees spent on the  
11 remand proceeding at the administrative level are not recoverable through the court. That is not what  
12 CCWC is doing in this case. CCWC is seeking recovery of the expenses it incurred, for the appeal  
13 and the remand, through this rate case. It is Staff's belief that the Commission has the authority to  
14 award these costs as part of this rate case.

15 Second, RUCO asserts that the Commission should deny CCWC's request based on public  
16 policy.<sup>25</sup> Specifically, RUCO indicates because CCWC made a business decision to appeal the  
17 Commission's decision for the benefit of its shareholders that it should not be entitled to recover that  
18 expense. However, RUCO's witness on this issue, Mr. Rigsby, was unable to provide any examples  
19 of when a decision to appeal would not be a business decision. Further, Mr. Rigsby testified that  
20 because the sole purpose of the appeal was to increase operating income, that CCWC should not be  
21 able to recover the legal expense of obtaining that increase. Nonetheless, when asked, Mr. Rigsby  
22 was not able to indicate with any certainty that the increase in operating income did not benefit  
23 ratepayers.<sup>26</sup> Also when asked whether denying rate case expense for the appeal and remand  
24 proceeding would have a deterrent effect, Mr. Rigsby responded as follows:

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<sup>24</sup> RUCO's Closing Br. at 10:12.

<sup>25</sup> *Id.* at 11:4.

<sup>26</sup> Tr. at 233-34.

1 A. I don't know that it would or not. I think that anytime you  
2 undertake an appeal, you know, there's always an element of risk  
3 involved. And, of course, the company is going to have to weigh  
4 whether or not the possible benefits of that are going to outweigh the  
risks. So no, I guess I don't really have an answer for that, you know,  
because it would depend on the circumstances of why they made the  
decision to go ahead and appeal or challenge a decision.<sup>27</sup>

5 If the Commission were to adopt RUCO's recommendation, utilities would never know  
6 whether or not they could recover expenses incurred in appealing a Commission decision. Staff and  
7 CCWC's recommendation is the more reasonable and rational approach and should be adopted by the  
8 Commission.

9 **D. Property Tax Expense.**

10 Staff and CCWC are recommending the same method for calculating property tax expense.  
11 The Commission approved this method in CCWC's prior rate case, and has used it consistently in  
12 numerous other rate cases. RUCO's witness Mr. Coley admitted that the method Staff and CCWC  
13 are utilizing has been approved by the Commission in prior rate cases.<sup>28</sup> Mr. Coley further agreed  
14 that RUCO was not "following [the] Commission approved methodology in this case."<sup>29</sup> The only  
15 rationale that RUCO provides for recommending a deviation from the methodology the Commission  
16 used in CCWC's prior rate case is that CCWC has been over collecting its property tax expense.  
17 RUCO fails to provide any other substantive basis for deviating from the methodology the  
18 Commission has consistently utilized in calculating property tax expense. Therefore the Commission  
19 should adopt the methodology that CCWC and Staff are recommending in this case.

20 **E. Amortization of Contributions in Aid of Construction.**

21 This issue is addressed in Staff's reply to the Company's closing brief.

22 **IV. REPLY TO PACIFIC LIFE INSURANCE COMPANY'S BRIEF.**

23 **A. Proper Notice of Irrigation Rate Increase.**

24 **1. Notice was sufficient.**

25 Pacific Life Insurance Company ("Pacific Life") raises several complaints in its brief  
26 regarding notice in this case. Staff contends that the notice was sufficient in this case. A.A.C. R14-

27 <sup>27</sup> Tr. at 234:12-20.

28 <sup>28</sup> Tr. at 295:21-25.

29 <sup>29</sup> *Id.* at 296:1-4.

1 2-105 requires a public service corporation to give notice to its customers in a manner prescribed by a  
2 procedural order. In the procedural order dated August 15, 2008, Administrative Law Judge Wolfe  
3 prescribed the notice. The Company complied with the direction given in the procedural order. The  
4 Company then filed its certification of publication and proof of mailing on September 4, 2008.

5 Pacific Life Insurance filed for intervention on September 15, 2008<sup>30</sup>, and was granted  
6 intervention in this matter on September 26, 2008<sup>31</sup>. Pacific Life Insurance did not raise any issues  
7 with notice once it was granted intervenor status, nor during the time that led up to the filing of direct  
8 testimony. Pacific Life failed to file any direct testimony and was not an active participant during the  
9 evidentiary hearings. Only during the closing brief stage, does Pacific Life make an issue of notice.  
10 While claims of inadequate notice or lack of notice are taken seriously by Staff, in this case, proper  
11 notice was accorded to all parties and customers.

12 **2. The notice period was sufficient.**

13 Pacific Life argues that the notice period was “extremely short”. Pacific Life states that a  
14 customer who wished to intervene had only 28 days to decide to intervene and only 43 days to file  
15 testimony from receipt of notice.<sup>32</sup> In a review of a previous Class A water utility rate case, the time  
16 frames were similar; publication was ordered by September 15, 2008; motions for intervention by  
17 October 1, 2008 and direct testimony due October 15, 2008.<sup>33</sup> Therefore, the times set in this case  
18 were not unusual. Pacific Life’s argument is without merit.

19 **3. Participation of other irrigation customers.**

20 Pacific Life states that “there is no way to know whether other irrigation customers would  
21 have intervened and participated in the case...”<sup>34</sup> However, that is always true in every case. The  
22 deadline for intervention was appropriately noticed. Therefore, Staff cannot assume that there would  
23 be additional intervenors if additional time was given.

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<sup>30</sup> Letter by Dale Hawley, docketed Sept. 15, 2008.

27 <sup>31</sup> Procedural Order, docketed Sept. 26, 2008.

28 <sup>32</sup> Pacific Life Closing Br. at 4.

<sup>33</sup> In the matter of Arizona-American Water Company for its Sun City Water District, Docket No. W-01303-07-0209.

<sup>34</sup> Pacific Life Closing Br. at 4.



1 The Original and 13 copies of the foregoing  
2 Were filed this 13<sup>th</sup> day of February, 2009, with:

3 Docket Control  
4 Arizona Corporation Commission  
5 1200 West Washington Street  
6 Phoenix, Arizona 85007

7 A copy of the foregoing was mailed this  
8 13<sup>th</sup> day of February, 2009, to:

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