



0000100990

BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

COMMISSIONERS

KRISTIN K. MAYES, Chairman
GARY PIERCE
SANDRA D. KENNEDY
PAUL NEWMAN
BOB STUMP

2009 JUL 24 A 11:28

AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF
SUNRISE WATER CO., AN ARIZONA
CORPORATION, FOR A DETERMINATION OF
THE CURRENT FAIR VALUE OF ITS UTILITY
PLANT AND PROPERTY AND FOR
INCREASES IN ITS RATES AND CHARGES
BASED THEREON FOR UTILITY SERVICE

DOCKET NO. W-02069A-08-0406

**NOTICE OF FILING
POST-HEARING BRIEF**

1 Sunrise Water Co. ("Sunrise") hereby files its Post-Hearing Brief in the above-captioned
2 matter.

3 RESPECTFULLY SUBMITTED on July 24, 2009.

4
5
6
7
8
9
10
11
12
13
14
15

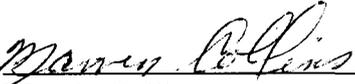
Craig A. Marks
Craig A. Marks
Craig A. Marks, PLC *By Maria E. Collier*
10645 N. Tatum Blvd.
Suite 200-676
Phoenix, AZ 85028
Craig.Marks@azbar.org
(480) 367-1956
Attorney for Sunrise Water Co.

Arizona Corporation Commission

DOCKETED

JUL 24 2009

DOCKETED BY *MM*

1 **Original** and 13 copies **filed**
2 on July 24, 2009, with:
3
4 Docket Control
5 Arizona Corporation Commission
6 1200 West Washington
7 Phoenix, Arizona 85007
8
9 **Copies** of the foregoing **delivered** on
10 July 24, 2009, to:
11
12 Wesley C. Van Cleve
13 Attorney, Legal Division
14 Arizona Corporation Commission
15 1200 West Washington
16 Phoenix, Arizona 85007
17
18 Ernest Johnson
19 Director; Utilities Division
20 Arizona Corporation Commission
21 1200 West Washington
22 Phoenix, Arizona 85007
23
24 Dwight D. Nodes
25 Assistant Chief Hearing Officer
26 Arizona Corporation Commission
27 1200 West Washington
28 Phoenix, Arizona 85007
29
30
31
32 By: 
Marvin Collins

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

KRISTIN K. MAYES, Chairman
GARY PIERCE
SANDRA D. KENNEDY
PAUL NEWMAN
BOB STUMP

IN THE MATTER OF THE APPLICATION OF
SUNRISE WATER CO., AN ARIZONA
CORPORATION, FOR A DETERMINATION OF
THE CURRENT FAIR VALUE OF ITS UTILITY
PLANT AND PROPERTY AND FOR
INCREASES IN ITS RATES AND CHARGES
BASED THEREON FOR UTILITY SERVICE

DOCKET NO. W-02069A-08-0406

SUNRISE WATER COMPANY'S POST-HEARING BRIEF

1	I. INTRODUCTION	2
2	II. RATE BASE.....	2
3	III. OPERATING INCOME	4
4	A. HYDRANT-WATER SALES	4
5	B. OUTSIDE SERVICES	7
6	C. BARN, WORKSHOP, STORAGE, FIELD OFFICE AND YARD RENTAL	8
7	D. RATE CASE EXPENSE	12
8	E. INCOME-TAX EXPENSE	13
9	IV. COST OF CAPITAL.....	15
10	V. REVENUE REQUIREMENT	15
11	VI. RATE DESIGN.....	16

1 **I. INTRODUCTION**

2 Because of a great deal of hard work on the part of Commission Staff (“Staff”) and
3 Sunrise Water Company (“Sunrise”), the parties have been able to substantially narrow the issues
4 yet to be resolved in this case. Nevertheless, there are several important issues where the parties
5 still disagree. Sunrise will address each remaining issue and provide its recommended resolution
6 for the Administrative Law Judge and the Commission.

7 Overall, the evidence and sound public policy justify a gross revenue increase for Sunrise
8 of \$222,943 (17.09%).

9 **II. RATE BASE**

10 The test year in this case ended on December 31, 2007.¹ Sunrise initially proposed Rate
11 Base Adjustment RLJ-6, which would have decreased Sunrise’s Advance balance by \$128,356 to
12 reflect the refund of Advances made in August of 2008. Staff opposed Sunrise’s proposal and
13 offered its Rate Base Adjustment No.2 restoring \$128,356 to Sunrise’s Advance balance.

14 In its rebuttal case, Sunrise offered to reduce the Advance balance adjustment by
15 approximately one-half (to reflect only the amount of the refund attributable to test-year
16 revenues).² The August 2008 payment was required by Commission rules and was based on
17 revenues generated during the period July 1, 2007, through June 30, 2008. By the end of the
18 2007 test year, six months of revenue for the 12-month refund period had been received by
19 Sunrise, creating a known-and-measurable liability for refund of Advances. In other words,
20 because of the test-year revenues, Sunrise was required to make a refund payment in 2008.
21 Because the refund obligation was accrued during the test year, the known-and-measurable
22 refund amount should be included as a pro-forma reduction to Advances in rate base. The effect
23 is to increase rate base by the amount of the adjustment.

¹ This paragraph, Exhibit A-6 at 4:27-32.

² This paragraph, Exhibit A-7 at 4:4-13.

1 Sunrise's request is consistent with Commission precedent.³ In Docket No. WS-01303A-
2 06-0403, Arizona-American Water Company requested that post-test-year refunds in the
3 amounts of \$3,068,719 and \$1,315,165 be added to the rate base of the Anthem Water District
4 and Anthem/Agua Fria Wastewater District, respectively. Staff and RUCO both accepted
5 Arizona-American's proposed adjustment without objection. The full amount of the post -test -
6 year refund was included in the total rate base recommended by Staff and RUCO. In Decision
7 No. 70372, dated June 13, 2008, the Commission included the post-test-year refunds in rate base.

8 Sunrise's proposal regarding post-test-year refunds is analogous to the adjustment
9 proposed and approved in the Arizona-American case.⁴ In both cases, the utility was
10 contractually required to refund advances in aid of construction during the following year for a
11 liability incurred during the test year. In Arizona-American's case, refunds were due in July
12 2006 based on customer-connection counts as of the December 31, 2005, end of the test year. In
13 Sunrise's case, Sunrise is requesting inclusion of that portion of the August 2008 refund that is
14 based on test-year revenues received during the period of July 1, 2007, through December 31,
15 2007. Just as in the Arizona-American case, the refund liability was fixed, known, and
16 measurable as of the end of the test year, and the refund was actually paid before rates went into
17 effect.

18 The equities in this case further support Sunrise's position. The Commission will likely
19 not issue its decision in this case until sometime this fall, with rates then going into effect very
20 late in 2009. If Staff's position were accepted, these rates would ignore a known-and-
21 measurable test-year obligation that will have actually been paid more than one year before rates
22 went into effect.

23 The Commission should approve a rate base of \$1,248,012 for Sunrise.
24

³ This paragraph, Exhibit A-7 at 3:1-16.

⁴ This paragraph, Exhibit A-7 at 3:20 - 4:3.

1 **III. OPERATING INCOME**

2 **A. HYDRANT-WATER SALES**

3 Sunrise and Staff are far apart as to the appropriate level of test-year hydrant-water sales.
4 They agree that these sales were abnormally high, but disagree concerning how much to reduce
5 them. Staff proposes to normalize sales by averaging hydrant-water sales between 2004 and
6 2007, but still uses a flawed methodology.

7 In general, Staff's methodology is flawed because it fails to recognize that there are two
8 distinct events that caused an unsustainable increase in Sunrise's hydrant-water sales during the
9 test year.⁵ First, Sunrise sold a large amount of water for the non-recurring Flood Control
10 Project during the 2007 test year. Second, due to the housing boom in the Phoenix market, base
11 hydrant-water sales (sales that exclude sales for the Flood Control Project) peaked sharply in
12 2006, began a steady decline in 2007, and then dropped precipitously in 2008 and 2009.

13 Because Staff does not address these two unique events separately, two distinct flaws in
14 Staff's proposed methodology are created.⁶ First, since Staff does not exclude the sales for the
15 Flood Control Project from its average, the non-recurring sales are inappropriately included in
16 the normalized level of hydrant-water sales proposed by Staff. Second, since Staff averages
17 sales over four years instead of a more appropriate five years as recommended by Sunrise, the
18 resulting normalized level of hydrant-water sales significantly overstates expected hydrant-water
19 sales on a going-forward basis.

20 The Flood Control Project was the 83rd Avenue / Pinnacle Peak Road Drainage
21 Improvement Project constructed by the Maricopa County Flood Control District, in cooperation
22 with the City of Peoria and Maricopa County Department of Transportation.⁷ The project was
23 designed to provide 100-year protection to the area between Calle Lejos and Deer Valley Roads,
24 and approximately 87th to 83rd Avenues and 10-year protection between 87th and 91st Avenues.

⁵ This paragraph, Exhibit A-7 at 6:3-8.

⁶ This paragraph, Exhibit A-7 at 6:9-15.

⁷ This paragraph, Exhibit A-3 at 3:24 – 4:19.

1 This project was an extremely large regional project, and not representative of normal
2 construction within Sunrise's service area. The project spanned across a full square mile of land
3 within the Sunrise service area and included the excavation of two massive retention basins, the
4 installation of several miles of storm drain piping, and associated repaving of numerous streets.

5 The Flood Control Project began in 2007 and was completed in 2008.⁸ In 2007, hydrant-
6 water sales for the Flood Control Project were 13,068,700 gallons, or fully 52.3% of total sales
7 during the test year. In 2008, hydrant-water sales for the Flood Control Project were 9,273,300
8 gallons, or 31.4% of total sales for the year. There are no similar projects being planned, and it
9 is unlikely that any projects of this scope will materialize in the foreseeable future in Sunrise's
10 service area. It would clearly be inappropriate to set rates at the end of 2009 based on non-
11 recurring sales from 2007 and 2008.

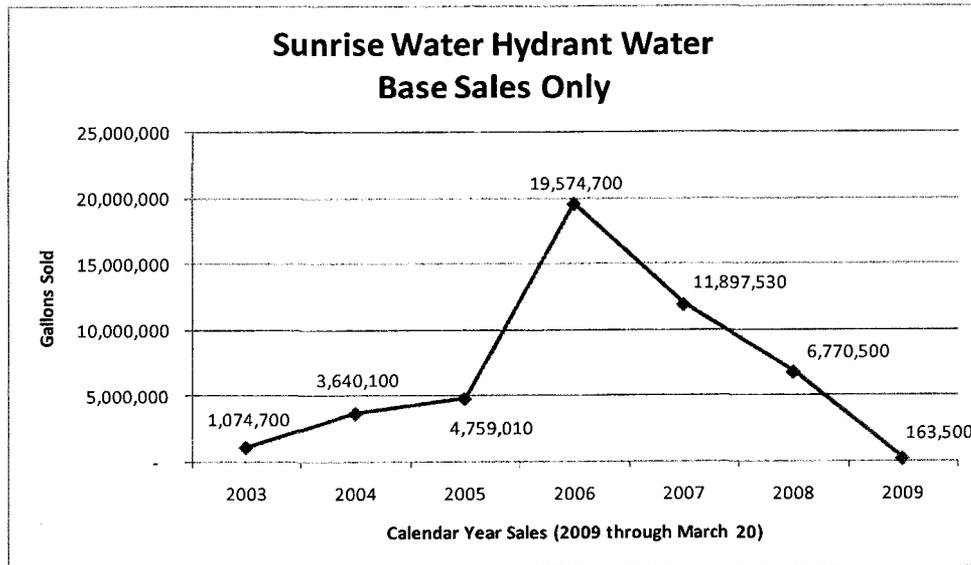
12 Staff's other flaw is that it over-weights hydrant-water sales from the recent construction
13 boom. Sunrise's base hydrant-water sales peaked dramatically in 2006. Beginning in the 2007
14 test year and continuing through 2008 and 2009, hydrant-water sales have steadily declined. This
15 pattern of hydrant water sales is directly correlated with the Phoenix area housing boom and bust
16 cycle.⁹

17 In his Rebuttal Testimony, Mr. Collins included the following graph of base hydrant
18 water sales:¹⁰

⁸ This paragraph, Exhibit A-3 at 6:20 – 7:3.

⁹ This paragraph, Exhibit A-3 at 9:19-23.

¹⁰ Exhibit A-3 at 10.



1 His graph clearly demonstrates that the 2007 test-year sales of 11,897,530 gallons were
 2 significantly above a normal level of hydrant sales for Sunrise and represent an unsustainable
 3 level of hydrant water sales. Mr. Collins also testified that 2009 hydrant-water sales will likely
 4 be less than 1,000,000 gallons.¹¹ This is less than 8.4% of test-year hydrant-water sales.

5 On balance, Mr. Collins establishes that the 2006-07 increase in base hydrant-water sales
 6 was a peaking event, rather than an ongoing trend to ever higher levels of sales.¹² To normalize
 7 a peaking event, one should equally weight data from low periods, moderate periods, and peak
 8 periods. Sunrise's proposed methodology uses one year of low sales (2003), two years of
 9 moderate sales (2004-2005), and two years of high sales (2006-2007). Sunrise's balanced
 10 approach results in normalized hydrant-water sales of 8,189,208 gallons.

11 Staff proposes to use two years of moderate sales (2004-2005) and two years of high
 12 sales (2006-2007), while ignoring years when sales were low.¹³ This method results in
 13 normalized hydrant-water sales of 13,234,760 gallons when Flood Control Project sales are
 14 included, and 9,967,835 excluding Flood Control Project sales. These levels of sales are 62%
 15 and 22% above Sunrise's proposed level of normalized sales.

¹¹ Exhibit A-4 at 2:15 – 3:3.

¹² This paragraph, Exhibit A-7 at 7:12-13

¹³ This paragraph, Exhibit A-7 at 7:14-18.

1 Staff's overweighting of moderate and high sales years might be appropriate if the
2 evidence established that Sunrise's hydrant-water sales were trending to ever higher level of
3 sales.¹⁴ However, as Mr. Collins shows, the hydrant-water sales trend is clearly back to and even
4 below historic low levels. Therefore, Sunrise's five-year average (using a balance of low sales,
5 moderate sales and high sales) is preferable to Staff's proposed four-year average, which over-
6 weights moderate and high sales years.

7 Based on current sales, it is clear that both Sunrise and Staff have grossly overestimated
8 the level of hydrant-water sales to be expected when the rates set in this case will be in effect.
9 Still it would make no sense to adopt the most grossly wrong estimate. The Commission should
10 approve Sunrise's test-year normalized hydrant-water sales of 8,189,208 gallons.

11 **B. OUTSIDE SERVICES**

12 SRW Consulting assists Sunrise with regulatory compliance by providing regulatory and
13 legislative monitoring and reporting services.¹⁵ In addition, SRW assists Sunrise to develop
14 communication strategies and manage issues encountered at State regulatory agencies including
15 the Commission. These services help ensure Sunrise is aware of new regulatory and legal
16 requirements and assist Sunrise in maintaining productive relationships with the numerous
17 agencies that oversee its operation. Sunrise procures these services because keeping current with
18 new regulatory and legal requirements and maintaining good relationships with regulatory
19 agencies is a vital component of providing water service in a heavily regulated business
20 environment. Accordingly, the services provided by SRW Consulting do directly benefit
21 Sunrise's customers.

22 In recognition that SRW Consulting occasionally engages in lobbying activities for
23 Sunrise, Sunrise has adjusted its rebuttal case to include 50% of the cost of the services provided
24 by SRW Consulting.¹⁶ The balance of the requested expense should be approved.

¹⁴ This paragraph, Exhibit A-7 at 7:19-23.

¹⁵ This paragraph, Exhibit A-3 at 11:12-22.

¹⁶ Exhibit A-3 at 12:11-13

1 **C. BARN, WORKSHOP, STORAGE, FIELD OFFICE AND YARD RENTAL**

2 Staff would disallow all expenses (\$37,595) associated with Sunrise's use of facilities
3 owned by Mr. Campbell including the use of a barn, workshop, storage, field office and yard.
4 Staff's reasons are difficult to understand.

5 It is undisputed that a water utility must use these types of facilities, but Staff would
6 disallow all costs, apparently because Mr. Campbell provides these facilities to Sunrise.

7 The supplies, material, tools, and equipment stored at these locations include brass
8 fittings and copper tubing, hand tools and power equipment and other miscellaneous water
9 facilities piping and fittings.¹⁷ These types of items are highly susceptible to theft and
10 vandalism. The location has a single source of ingress and egress and is a fenced and occupied,
11 large acreage, ranch-style, residential property. These features provide excellent security and
12 protect the items from theft and damage. In addition, Sunrise records are stored in secure
13 containers on the property.

14 The area also provides a safe, secure area to park utility vehicles overnight and on
15 weekends.¹⁸ This protects them from vandalism and makes them available for maintenance
16 (vehicle washing, oil and fluid changes, tire service, tune-ups, and other routine services) at the
17 nearby workshop/barn.

18 The workshop in the barn is used by field crews to make repairs and to perform other
19 equipment functions, and the field office is used for field crew meetings and staging.¹⁹ The
20 workshop is used by Sunrise's field personnel on a regular basis and contained water company
21 materials and parts at the time of Staffs visit. Small parts and tools are stored within the
22 workshop to work on such items as fittings on hydrant meters, chlorine pumps and motors, small
23 booster pumps and motors, and other water distribution and pumping equipment. Additionally,
24 as discussed above, Sunrise personnel perform minor maintenance on the vehicles at the
25 workshop/barn location.

¹⁷ This paragraph, Exhibit A-3 at 13:3-9.

¹⁸ Tr. at 11:3-6.

¹⁹ This paragraph, Exhibit A-3 at 13:9-20.

1 The test-year expense of \$37,595 amounts to just over \$3,000 per month. On its face,
2 this is a reasonable rent expense. Staff has not suggested that Sunrise could rent similar secure
3 facilities for any less. Instead, Staff suggests that Sunrise should develop its Well No. 7 site for
4 secure storage and maintenance. This alternative would most likely be impossible, and, in the
5 unlikely event that it could be accomplished, the cost would far exceed \$37,595 per year.

6 The Well No. 7 site is certainly large enough, but this means nothing. Sunrise was
7 required to purchase a 1.83-acre site because a well was needed, the area was zoned one-acre
8 minimum, available property was limited, and this was the only such location with the desirable
9 hydrological characteristics.²⁰ The site is fenced with a block wall and in addition to the well
10 itself, contains a 500,000 gallon storage tank, five booster pumps, the well pump, and a control
11 building with an electrical room and a room that houses the chlorination equipment.²¹ Without
12 any further analysis, the Well No. 7 site sounds like it could serve for facility maintenance, parts
13 storage, and vehicle parking. However, this is impossible for several reasons.

14 In order to secure the supplies, material and tools at Well Site No. 7, Sunrise would have
15 to construct a new, adequately-sized, building.²² Sunrise estimates that the construction cost of a
16 structure of adequate size to replace the existing facilities would be at least \$150,000.00,
17 including design and permitting. There would also be significant monthly utility bills for
18 electricity, sewer, garbage, and security services. Contrary to Staff's assertion that use of Well
19 Site No. 7 would be at no cost to ratepayers, the resulting revenue requirement and the associated
20 monthly operating costs associated with a building would be significant.

21 However, cost is not the biggest obstacle to overcome.²³ Well No. 7 is located within
22 unincorporated Maricopa County and is zoned R43, which is a minimum one-acre residential lot.
23 Maricopa County R43 zoning allows for water wells and booster stations to be installed, but the

²⁰ Tr. at 30:7-12; Tr. 33:6-8. Exhibit A-3 at 14:11-13. Because of the one-acre zoning, the 0.83 acres above the zoning minimum would not be buildable, which makes the "excess" land not salable and valueless for rate-making purposes. Tr. at 51:18 – 52:1.

²¹ Tr. at 29:9-24.

²² This paragraph, Exhibit A-3 at 14:4-10.

²³ This paragraph, Exhibit A-3 at 14:11-15.

1 Maricopa County R43 zoning does not permit building any type of office or storage facility on
2 the site.

3 Construction of a storage facility will require either a Special Use Permit or rezoning of
4 the site.²⁴ Under County zoning regulations, a Special Use Permit is only allowed if the County
5 considers a storage facility as being attendant to the primary use of the site as a booster station.
6 The County would not consider a large equipment maintenance/storage facility, together with
7 vehicle parking and external pipe storage, to be attendant to the use of the site as a booster
8 station. Rezoning the site would likely prove very problematic, if not impossible. Zoning
9 applications in the Sunrise service area are routinely challenged to protect the one-acre home
10 sites from commercial traffic and disruption, making the probability of rezoning the site low.

11 Mr. Collins contacted Mr. Harry Stelling in the Planning and Development Department at
12 Maricopa County.²⁵ Mr. Stelling verified that any enclosed or outdoor storage at the site would
13 require a Special Use Permit or rezoning the site. Mr. Stelling provided a flow chart describing
14 the extensive County process for obtaining a Special Use Permit or rezoning the site, which Mr.
15 Collins attached to his testimony. A copy of that flow chart follows:

²⁴ This paragraph, Exhibit A-3 at 14:16-23.

²⁵ This paragraph, Exhibit A-4 at 5:10-14; Exhibit MEC-RJ1.

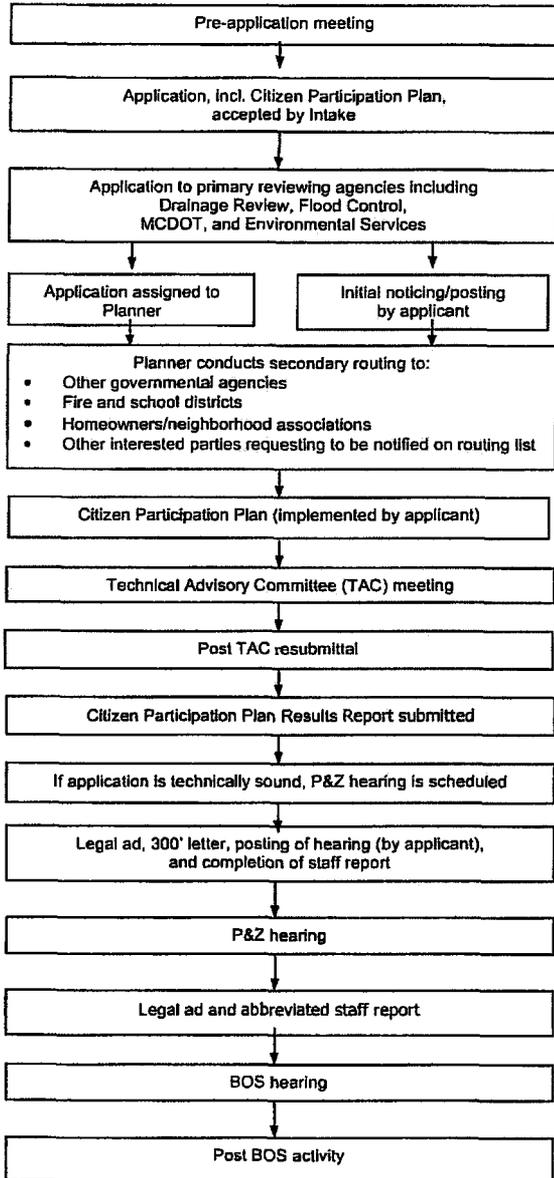


Planning & Development Department

ZONE CHANGE/SUP PROCESS



PROJECT FLOW CHART



PRE-APPLICATION MEETING

A pre-application meeting is required for all cases. Possible items of discussion may include requirements, citizen participation plan, community and area plans, zoning patterns and trends. The pre-application meeting will include other County agencies such as Transportation, Drainage Review, Flood Control and Environmental Services.

After the meeting and after consulting with staff, the applicant may begin implementing the Citizen Participation Plan.

FILING AN APPLICATION

To submit an application, the following information is required:

- Pre-application meeting, application, and "Property Owner Authorization" forms (if applicable).
- Verification of ownership of the site, such as a recorded deed.
- Application fees for Planning, Drainage Review, and Transportation.
- Photographs of the site and adjacent properties.
- Precise Plan of Development (also known as a Site Plan). A Preliminary Plat may substitute, if applicable.
- Narrative Report, describing the request, justification for the request, property and area conditions, potential impacts, proposed improvements, services, utilities, etc.
- Other information such as building elevations and details, floor plans, sign details, landscape plans, architectural renderings, a drainage report and/or a traffic impact study.
- Citizen Participation Plan, describing the parties contacted by the applicant, how information about the application is disseminated, how inquiries are handled, schedule of completion, etc.

1 Clearly, just to request the required zoning authority would be a lengthy, expensive
2 process, with little likelihood of success. Even if the zoning approval could be obtained and the
3 storage building constructed, Staff's suggestion would certainly cost customers far more than the
4 nominal cost of maintaining the status quo.

5 Finally, in the recent West End Water Co. ("West End") rate case, Docket No. W-
6 01157A-06-0004, Decision No. 68925 dated August 29, 2006, the Commission included
7 expenses of \$12,286.00 for rental expense for these facilities. Using the standard 80% / 20%
8 split of costs between Sunrise and West End, this equates to an expense of \$49,144.00 for
9 Sunrise. Sunrise is actually asking for only \$37,595 of rental expenses in this case, more than
10 \$11,000 less than it could have justified based on Commission precedent.

11 **D. RATE CASE EXPENSE**

12 In its rejoinder case, Sunrise updated its rate-case expense request to \$90,000.²⁶ Through
13 month-end March 2009, Sunrise had expended approximately \$64,500 in rate case expenses. To
14 finish the case Sunrise needed to continue to engage a consultant and attorney to analyze Staff's
15 surrebuttal testimony, prepare and file rejoinder testimony, prepare for hearing, participate in the
16 hearing, prepare closing briefs and attend Open Meeting. Sunrise estimated this additional
17 expense would be approximately \$25,500, for a total rate-case expense of \$90,000.²⁷ Mr. Jones
18 updated Income Statement RLJ-18 to reflect an annual rate case expense amortization of
19 \$30,000.

20 The three-year amortization period is appropriate. Sunrise expects to be forced to soon
21 file another rate case to recover substantial additional utility investment not yet in rate base, and
22 to adjust for increased expenses, particularly in electricity provided by Arizona Public Service.²⁸

²⁶ This paragraph, Exhibit A-7 at 18:14-20

²⁷ Exhibit A-8.

²⁸ Tr. at 130:9 – 131:11.

1 **E. INCOME-TAX EXPENSE**²⁹

2 This is clearly the most contentious issue in the case. Staff proposes that Sunrise be
3 allowed no income-tax expense in the test year. The crux of Staff's argument is that a
4 Subchapter S Corporation ("S-Corp") does not pay taxes directly. As a non-taxable entity, it
5 passes all tax liability through to its shareholder(s). Staff could offer no other reason for its
6 position.³⁰

7 There is no dispute that Sunrise is an S-Corp. Staff agreed that there should be no
8 differences in the tax-treatments of an LLC or an S-Corp.³¹ Staff also does not dispute that the
9 Commission allows recovery of tax expense for C-Corps like APS, Tucson Electric Power, and
10 Southwest Gas, even though these entities do not pay taxes directly, but just like an LLC or S-
11 Corp pass through tax-expense to the ultimate shareholders.

12 Staff's position is discriminatory and unfair. Staff bases its recommendation on a
13 technical distinction, rather than fairly and fully evaluating the effect of income taxes on various
14 forms of legal entities. Sunrise agrees with the policy behind the New Mexico Supreme Court
15 case cited by Mr. Jones – technical distinctions are not sufficient grounds to reject Sunrise's
16 request for income tax expense.³² Since the Arizona commission uses hypothetical income tax
17 calculations when determining the amount of income tax to include in the expenses of
18 consolidated C-Corps, it has effectively agreed with the New Mexico Supreme Court's statement
19 "that the fundamental inquiry is not limited to technical distinctions, but is determined by
20 practical economic facts." Sunrise simply requests that it not be discriminated against relative to
21 the numerous C-Corps that are part of consolidated groups receiving income tax recovery in
22 Arizona. The *practical economic fact* is that the regulated activities of both S-Corps and C-
23 Corps generate income-tax liabilities that must be paid by the ultimate shareholder(s).

²⁹ This section largely summarizes Exhibit A-15, Mr. Jones' Supplemental Testimony on the subject of income-tax expense recoverability for S-Corps and LLCs.

³⁰ Tr. at 320:2 – 323.4.

³¹ Tr. at 321:6-9.

³² *Moyston v. New Mexico Public Service Commission*, 76 N.M. 146, 160; 412 P.2d 840, 850 (1966).

1 The net income generated by Sunrise through the provision of regulated water services is
2 subject to State and Federal income tax. The passed-through tax liability would not exist absent
3 the provision of regulated water services by Sunrise. Using the words of the Texas Supreme
4 Court, the taxes paid by Mr. Campbell on the income of Sunrise are “inescapable business
5 outlays and are directly comparable with similar corporate taxes.”³³ Like any other expense
6 prudently incurred in the operation of a regulated entity, the income-tax expense should be
7 recovered in rates of the regulated entity, unless circumstances particular to the regulated entity
8 warrant a disallowance of the income tax expense.

9 It is undisputed that the net income generated by Sunrise through the provision of
10 regulated water services is subject to State and Federal income tax. The passed-through tax
11 liability would not exist absent the provision of regulated water services by Sunrise, and is an
12 expense incurred in the provision of water service by Sunrise. Further, if the expense is not
13 recovered, then fewer funds would be available for investment in the business. As such, the
14 income-tax expense should be recovered in rates of the regulated entity.

15 The *pro forma* income-tax expense proposed by Sunrise is calculated consistent with the
16 method used by the Commission to calculate income-tax expenses for C-Corps that are members
17 of a consolidated group. It represents a fair and reasonable level of income tax expense to be
18 included in the rates for Sunrise. Treating Sunrise differently than APS, Southwest Gas,
19 Arizona-American Water, Arizona Water, Chaparral City Water, and the numerous other C-
20 Corps that are part of consolidated groups is discriminatory and unfair to Sunrise, other S-Corps,
21 LLCs, and their respective customers.

22 Sunrise concedes that there are some jurisdictions that have not allowed S-Corps or LLCs
23 to recover income-tax expenses. However many of these jurisdictions base their disallowances
24 on an ‘actual taxes paid’ doctrine. The Commission has not adopted this doctrine, because it
25 allows hypothetical standalone income-tax calculation for C-Corps filing consolidated tax

³³ *Suburban Utility Corp. v. Public Utility Com'n of Texas*, 652 S.W.2d 358, 364 (Tex. 1983).

1 returns. Arizona does not require a utility to demonstrate the actual taxes paid by its parent
2 shareholder, such as for APS to provide evidence of the actual taxes paid by Pinnacle West.

3 Even if the Commission did require that a utility demonstrate the actual taxes paid by its
4 parent shareholder, Sunrise would be allowed recovery of income-tax expense. Mr. Campbell
5 paid income taxes on Sunrise's test year taxable income of \$258,646 at a combined federal and
6 state marginal rate of 32.5% and an overall effective rate of 23.0%. This results in actual taxes
7 paid of \$84,060 using the marginal rate approach and \$59,489 using the effective rate approach.

8 The Commission should reject Staff's short-sighted objection to the recovery of income-
9 tax expense by S-Corps and LLCs. These entity forms are favored by Arizona's smaller water
10 and wastewater companies. There is no reason to discriminate against these entities in favor of
11 C-Corps that also do not pay taxes. The Commission is well aware of the challenges small water
12 and wastewater companies face to raise the funds needed to maintain and upgrade infrastructure,
13 particularly to meet new federal drinking-water standards. Raising these funds would only be
14 more difficult if they are denied recovery of legitimate business expenses.

15 **IV. COST OF CAPITAL**

16 Sunrise and Staff agree that Sunrise's cost-of-equity is 10.0% and its capital structure is
17 100% equity.

18 **V. REVENUE REQUIREMENT**

19 Based on the evidence in this case, the Commission should approve the following
20 revenue requirement for Sunrise:

21	Original Cost Adjusted Rate Base	\$ 1,248,012
22	Adjusted Operating Income	(32,542)
23	Current Rate of Return	-2.61%
24	Required Operating Income	\$ 124,801
25	Required Rate of Return	10.00%
26	Operating Income Deficiency	\$ 157,344
27	Gross Revenue Conversion Factor	1.4169

