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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

Arizona Corporation Commission

DOCKETED

OCT 21 2009

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

DOCKETED BY
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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.

DOCKET NO. W-02113A-07-0551

DECISION NO. 71308

OPINION AND ORDER

DATES OF HEARING: December 5, 2008 (Pre-Hearing); December 8, 9, and 10, 2008, and January 8 and 9, 2009.

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Teena Wolfe

APPEARANCES: Mr. Norman D. James and Mr. Jay L. Shapiro, FENNEMORE CRAIG, on behalf of Chaparral City Water Company;

Ms. Michelle L. Wood, Attorney, on behalf of the Residential Utility Consumer Office;

Ms. Robin Mitchell, Ms. Amanda Ho, and Mr. Wesley Van Cleve, Staff Attorneys, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

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1 **BY THE COMMISSION:**

2 **I. INTRODUCTION**

3 On September 26, 2007, Chaparral City Water Company, Inc. ("Company" or "CCWC") filed
4 with the Arizona Corporation Commission ("Commission") an application for a rate increase, based
5 on a test year ended December 31, 2006.

6 On October 26, 2007, the Commission's Utilities Division ("Staff") filed a letter stating that
7 the application was found sufficient and classifying the Applicant as a Class A utility.

8 On November 19, 2007, the Residential Utility Consumer Office ("RUCO") filed an
9 Application to Intervene.

10 By Rate Case Procedural Order issued November 30, 2007, a hearing was set on the
11 application to commence on July 8, 2008, associated procedural deadlines were set, and intervention
12 was granted to RUCO.

13 On December 19, 2007, the procedural schedule set by the initial Rate Case Procedural Order
14 was modified as requested by the Company, with the hearing set to commence on July 21, 2008.

15 On January 22, 2008, a Procedural Order was issued granting a January 3, 2008, motion by
16 Staff to suspend the timeclock in this proceeding, until the Commission's final order in Docket No.
17 W-02113A-04-0616, a pending matter in which the rates of Chaparral City Water Company, Inc.
18 were also being considered. The parties were ordered to continue to conduct discovery and case
19 preparation to the greatest extent possible during the duration of the continuance in order to minimize
20 any delay in implementation of new rates pursuant to this application.

21 By the Second Amended Rate Case Procedural Order issued on July 24, 2008, the hearing
22 was set to commence on December 8, 2008. The Second Amended Rate Case Procedural Order set
23 the deadline for intervenor direct testimony at September 30, 2008, and the deadline for intervenor
24 surrebuttal testimony at November 18, 2008.

25 On September 15, 2008, Pacific Life Insurance Company dba Eagle Mountain Golf Club
26 ("Pacific Life"), a commercial customer of CCWC, filed a Motion to Intervene, which was granted
27 by Procedural Order issued September 26, 2008.

28

1 On September 30, 2008, a Procedural Order Extending Filing Deadlines was issued,
2 extending the deadline for intervenor direct testimony to October 3, 2008, and extending the deadline
3 for intervenor surrebuttal testimony to November 20, 2008.

4 RUCO and Staff filed direct testimony on September 30, 2008, and October 3, 2008,
5 respectively.

6 On October 24, 2008, Staff filed a Notice of Filing of Meeting on Settlement, and on October
7 28, 2008, Staff filed a Corrected Notice of Filing of Meeting on Settlement.

8 On October 31, 2008, the Company filed its rebuttal testimony.

9 On November 12, 2008, Pacific Life filed a Notice of Appearance of Counsel, indicating a
10 change of counsel.

11 On November 21, 2008, Staff filed a Notice of Witness Substitution and Request for
12 Procedural Order. Staff requested that it be allowed to file substitute witness Mr. Parcell's surrebuttal
13 testimony on cost of capital on December 3, 2008, and requested a date certain of December 15,
14 2008, for Mr. Parcell's live testimony.

15 On November 24, 2008, the Company filed its Response objecting to Staff's November 21,
16 2008 filing, and on November 26, 2008, Staff filed a Reply to the Company.

17 On December 2, 2008, a Procedural Order was issued granting Staff's request to file the
18 surrebuttal testimony of its substitute witness on December 3, 2008, and indicating that the dates
19 certain requested by Staff for presentation of its expert witness were not available for hearing, but
20 that a suitable schedule for proceeding with the parties' presentation of their cases on cost of capital
21 would be discussed at the prehearing conference scheduled for December 5, 2008.

22 The prehearing conference was held as scheduled. The Company, RUCO and Staff appeared
23 through counsel. Pacific Life did not enter an appearance. The Company stated an objection to
24 Staff's substitute witness Parcell's prefiled surrebuttal testimony, and the objection was discussed.
25 Staff agreed to make a filing regarding Mr. Parcell's adoption of Staff witness Mr. Chaves'
26 testimony. A date for Mr. Parcell to appear for cross-examination was discussed, but not determined,
27 during the prehearing conference.

28 On December 8, 2008, the hearing convened as scheduled and public comment was taken.

1 The Company, RUCO and Staff appeared through counsel, presented evidence and cross-examined
2 witnesses on all issues with the exception of cost of capital and rate of return. Pacific Life did not
3 appear. The hearing was recessed on December 10, 2008, and reconvened on January 8, 2009, for
4 the purpose of taking evidence on the bifurcated issues of cost of capital and rate of return. The
5 hearing concluded on January 9, 2009.

6 The parties subsequently submitted closing and reply briefs which were bifurcated in the same
7 manner as the hearing, with the final round of reply briefs filed on February 27, 2009.

8 In its reply brief on the issue of cost of capital, Staff requested that in light of the Company's
9 restating of arguments regarding the methodologies employed in Decision No. 70441, in order to
10 have a complete record in this case, that either Staff's testimony in the proceeding leading to
11 Decision No. 70441 ("Remand Proceeding") be admitted as a late-filed exhibit, or that administrative
12 notice be taken of the complete record of Docket No. W-02113A-04-0616. Due to the continuing
13 litigation on the issue of an appropriate fair value rate of return ("FVROR") methodology,
14 administrative notice is taken of the complete record of Docket No. W-02113A-04-0616.

15 On February 18, 2009, Staff docketed an update to its February 10, 2009, Motion to Compel.¹
16 Staff indicated that Staff and the Company had agreed to extend the time period in which the
17 Company has to respond, pending the outcome of ongoing negotiations to resolve the Motion to
18 Compel.

19 On March 4, 2009, the Company filed a Notice of Filing Late-Filed Exhibit. The exhibit
20 attached thereto is a rate case itemization spreadsheet showing a total for January 2007 - December
21 2008.

22 On June 3, 2009, a Procedural Order was issued directing Staff to file, by June 12, 2009, an
23 update regarding its Motion to Compel and the progress made in its discovery regarding the CPUC
24 investigation. The Procedural Order further directed that the update include a recommendation
25 regarding an appropriate procedural means of addressing the CPUC investigation issue, including

26 ¹ The Motion to Compel is related to an ongoing investigation by Staff. On January 5, 2009, Staff filed a Notice of Filing
27 Regarding Investigation. The Notice stated that the California Public Service Commission ("CPUC") had contacted Staff
28 regarding a CPUC investigation of Golden States Water Company ("Golden States"), an affiliate of CCWC. The CPUC
had alerted Staff that in the course of a CPUC investigation into Golden States, the CPUC had discovered information
relating to CCWC that it thought would be of interest to Staff.

1 whether it should be addressed in this docket, and directed the Company, Pacific Life and RUCO to
2 file responses.

3 On June 11, 2009, Staff filed a Request for Extension of Time, requesting that it be allowed to
4 file its update by June 19, 2009.

5 On June 12, 2009, the Company filed a Response in Opposition to Staff's Motion for
6 Extension of Time. Therein, the Company stated that it had offered to stipulate to either (1) keep this
7 docket open, pending conclusion of Staff's review of the CPUC investigation documents and a
8 determination of whether any further proceedings or relief are warranted, or (2) to open a new docket
9 for the same purpose, but that Staff had not definitively responded to the stipulation offer.

10 On June 17, 2009, RUCO filed a Response to Staff's Request for Extension of Time.

11 On June 17, 2009, a Procedural Order was issued granting Staff a one-week time extension,
12 and extending the time for filing responses thereto.

13 On June 19, 2009, Staff filed its Update and Reply to Chaparral City Water Company's
14 Response. Staff stated that ultimately, Staff and the Company had resolved their discovery dispute
15 through the execution of a protective agreement, upon which the Company provided Staff with over
16 15,000 pages of documents. Staff stated that its investigation is ongoing, and that Staff had not yet
17 determined whether the Company's activities rise to the level of impropriety or wrongdoing or
18 impact the Company's rates or this pending rate case. Staff stated that it had retained an outside
19 consultant to assist in Staff's review of the documents and to determine whether any alleged
20 improprieties have impacts for this rate case. Staff stated that it found the Company's stipulation
21 proposal acceptable, as long as all parties acknowledge that rates could be modified if the
22 investigation yields circumstances which would warrant such action.

23 On June 23, 2009, RUCO filed its Response to Staff's Update Regarding the CPUC
24 Investigation. RUCO agreed with Staff that there had been insufficient time to review and analyze
25 the documentation which the Company produced on March 10, 13 and 16, 2009. RUCO stated that it
26 did not object to having this matter proceed, but with the docket remaining open subject to
27 reconsideration in the event that the investigation by Staff, RUCO, or the CPUC reflects impropriety
28 by Chaparral or its parent, officers or employees.

1 On June 25, 2009, the Company filed a Response to Staff's Update. The Company asserted
 2 that there is no reason to delay rate relief, and requested the issuance of a decision in this matter as
 3 soon as possible.

4 This matter was subsequently taken under advisement, and a Recommended Opinion and
 5 Order was submitted for the Commission's consideration.

6 II. APPLICATION

7 CCWC, a California corporation in good standing in Arizona, is an Arizona public service
 8 corporation that holds a Certificate of Convenience and Necessity ("CC&N") authorizing it to
 9 provide water utility service within a service territory that is located in the northeastern portion of the
 10 Phoenix metropolitan area, in the Town of Fountain Hills and in a small portion of the City of
 11 Scottsdale.² During the test year, CCWC served 13,333 customers, including 12,431 residential, 375
 12 commercial and 442 irrigation customers.³ CCWC is in compliance with all federal, state, county
 13 and Commission requirements.⁴

14 On September 26, 2007, CCWC filed this rate increase application with the Commission
 15 based on a test year ended December 31, 2006. CCWC is currently charging rates approved in
 16 Decision No. 68176 (September 30, 2005), as modified by Decision No. 70441 (July 28, 2008), based
 17 on a test year ending December 31, 2003. The Company is requesting a gross revenue increase of
 18 \$2,852,353, which is an increase of 38.01 percent over test year revenues of \$7,505,010.⁵ The
 19 Company's requested revenues are based on its proposed rate of return of 9.96 percent on a fair value
 20 rate base ("FVRB") of \$27,751,113. The Company's FVRB is derived from a 50/50 weighting of an
 21 Original Cost Rate Base ("OCRB") of \$22,647,882, and a Reconstruction Cost New Rate Base
 22 ("RCND") of \$32,854,345. The Company proposes adjusted test year revenues of \$7,505,010 and
 23 test year operating expenses of \$7,646,730.

24 ...

25 ...

26 ² Direct Testimony of Company witness Robert N. Hanford (Exh. A-1) at 3-5.

27 ³ Direct Testimony of Company witness Thomas J. Bourassa (Exh. A-3), Schedule H-2 at 1.

28 ⁴ Direct Testimony of Staff witness Marlin Scott, Jr. (Exh. S-1) at 5-6.

⁵ These figures are from the Company's Amended Final Schedule A-1. The Application originally sought a \$3,063,400 increase in its revenue requirement, an increase of 41.14 percent over test year revenues.

1 **III. RATE BASE ISSUES**

2 **A. Treatment of the FHSD Settlement Proceeds**

3 The Fountain Hills Sanitary District ("FHSD") provides wastewater collection and treatment
 4 for most of CCWC's service area. FHSD needed to construct an Aquifer Storage and Recovery
 5 ("ASR") well in the vicinity of the Company's Well No. 9.⁶ While CCWC's primary water supply is
 6 imported Colorado River water, which is delivered by means of the Central Arizona Project
 7 ("CAP"),⁷ the Company blended CAP water with water from its Well No. 9 and two other wells.⁸
 8 The Company and FHSD entered into negotiations on a well exchange agreement, under which
 9 FHSD would supply CCWC with a new well similar in production and water quality to Well No. 9.⁹
 10 FHSD was unable to drill a well that yielded results satisfactory to the Company, and in January
 11 2005, the parties entered a Well Transfer Agreement under which FHSD paid CCWC \$1.52 million
 12 in consideration for CCWC ceasing use of Well No. 9 and Well No. 8 (a non-potable well), and
 13 CCWC giving FHSD an option to purchase the real property on which Well No. 8 is located.¹⁰

14 The Company proposes to treat the proceeds of the settlement in a manner that shares the
 15 benefit equally between ratepayers and shareholders.¹¹ The Company relied on the Commission's
 16 treatment of the Pinal Creek Group Settlement ("PCG Settlement") issue in Decision No. 66849
 17 (March 19, 2004) as a guide for its proposal in this case.¹² CCWC contends that it acted in the public
 18 interest by protecting its interests and those of its ratepayers by turning two aged wells, one of which
 19 was never in service, into cash and seeking to share those proceeds with its ratepayers.¹³ At the
 20 hearing, Staff's witness stated that for policy reasons, Staff agrees with the Company that the
 21 settlement proceeds should be shared equally between the shareholders and ratepayers so long as the
 22 Company shares the proceeds equally with the ratepayers in the event the wells are sold.¹⁴ The
 23

24 ⁶ Direct Testimony of Company witness Robert N. Hanford (Exh. A-1) at 10; Tr. at 118.

25 ⁷ *Id.* at 3-5.

26 ⁸ *Id.* at 3; Tr. at 101.

27 ⁹ *Id.* at 10.

28 ¹⁰ *Id.*

¹¹ *Id.* at 10-11; Rebuttal Testimony of Company witness Thomas J. Bourassa (Exh. A-5) at 13-15; Rebuttal Testimony of Company witness Robert N. Hanford (Exh. A-2) at 1-4.

¹² Company Brief at 7; Company Reply Brief at 9. The PCG Settlement is discussed at pp. 32-37 of Decision No. 66849.

¹³ Company Reply Brief at 9.

¹⁴ Tr. at 351-52.

1 Company is willing share the gain with ratepayers in the event the wells are ever sold.¹⁵

2 RUCO disagrees with the Company's proposal, and recommends that the Company be
3 required to distribute the \$1.52 million settlement proceeds to ratepayers minus the associated legal
4 fees.¹⁶ While the Company argues that disallowing the sharing of the FHSD proceeds would serve as
5 a disincentive to utilities to pursue litigation or settlement to protect assets,¹⁷ RUCO responds that in
6 some cases, sharing of settlement proceeds may be appropriate, and that it does not object to the
7 Company recovering its legal expenses associated with the settlement in this case.¹⁸ RUCO disagrees
8 with Staff's position on this issue, contends that Staff's change in recommendation for policy reasons
9 during the hearing is not supported by testimony or evidence,¹⁹ and argues that the prefiled testimony
10 of Staff's witness, entered into the record prior to Staff's changed position on the issue at the hearing,
11 supports its position.²⁰ RUCO asserts that the FHSD settlement proceeds should be allocated 100
12 percent to CCWC's ratepayers because Well No. 8 and Well No. 9 were constructed over 36 years
13 ago, have been fully depreciated, and have no impact on rate base in this case.²¹ RUCO contends that
14 the Company has fully recovered the cost of the wells and received a reasonable return thereon, and
15 therefore is not entitled to any of the settlement proceeds.²² RUCO argues that 100 percent of the
16 settlement proceeds should go to ratepayers, because, according to RUCO, the FHSD settlement
17 proceeds compensate CCWC for an equivalent cost of water to replace the amount Well No. 9 would
18 have produced over the remainder of its useful life, and RUCO believes ratepayers will have to pay
19 100 percent of the cost of replacement water.²³ RUCO contends that this FHSD issue is
20 distinguishable from the PCG Settlement issue, because "there is no evidence in Decision No. 66849
21 that the Company fully recuperated its investment of and on the contaminated wells."²⁴ RUCO also
22 contends that this FHSD issue is distinguishable from the PCG Settlement issue, because Arizona

23 ¹⁵ Rebuttal Testimony of Company witness Robert N. Hanford (Exh. A-2) at 3-4; Tr. at 352-53.

24 ¹⁶ RUCO Brief at 9.

¹⁷ Company Brief at 10.

25 ¹⁸ RUCO Brief at 9.

¹⁹ RUCO Reply Brief at 10-11.

26 ²⁰ RUCO Brief at 10; RUCO Reply Brief at 8-9, citing Tr. at 416-17 and Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 13

27 ²¹ RUCO Brief at 8; Exh. R-10 (Company Response to Staff Data Request MEM 7.3).

²² RUCO Brief at 8.

28 ²³ *Id.*

²⁴ *Id.* at 9.

1 Water received replacement water and wells in that case.²⁵

2 As RUCO points out and the Company admits, Wells 8 and 9 are fully depreciated. The
3 Company and its shareholders have received the full return of and on their investment in Wells 8 and
4 9 and are entitled to no more. We are cognizant, however, that the Company spent \$30,000 in
5 attorneys' fees and costs in pursuing the resolution with the FHSD. We hereby grant \$30,000 of the
6 proceeds to the Company for pursuing the matter on behalf of ratepayers and allocate the remaining
7 settlement proceeds to the ratepayers.

8 **B. Treatment of the Additional CAP Water Allocation Acquisition Cost**

9 At the end of the test year, the Company had a CAP water allocation allowing it to take up to
10 6,978 acre-feet of Colorado River water annually.²⁶ Under that contract, the Company also has the
11 right to buy excess CAP water,²⁷ and has exercised that right in each of the last two years.²⁸ As a
12 result of the Arizona Water Settlement Act of 2004, CCWC had an opportunity to purchase an
13 additional CAP allocation of 1,931 acre-feet per year.²⁹ CCWC states that when presented with the
14 opportunity, it considered the unavailability of additional CAP water and other renewable water
15 supplies, and paid \$1.28 million for the additional CAP allocation in December, 2007.³⁰ As with its
16 first CAP allocation, its contract for the additional CAP allocation requires the Company to pay
17 annual Municipal and Industrial ("M&I") capital charges based on the size of the additional CAP
18 allocation, and to pay purchased water charges based on annual water use.³¹

19 Parties' Positions

20 CCWC states that it acquired the additional CAP allocation to ensure its long-term water
21 supply, including an increase to its drought buffer from both intrastate and interstate demand for
22 Colorado River water supply,³² and to reinforce and continue its reliance on renewable water
23 supplies.³³ CCWC contends that full cost recovery is warranted because the additional CAP

24 ²⁵ Decision No. 66849 at 34.

25 ²⁶ Direct Testimony of Staff Witness Marlin Scott, Jr. (Exh. S-1), Engineering Report at 11.

26 ²⁷ Tr. at 140-141.

27 ²⁸ Company Brief at 10, fn 36 and Exhibit 1.

28 ²⁹ Direct Testimony of Company witness Robert N. Hanford (Exh. A-1) at 5.

³⁰ Company Brief at 10.

³¹ Direct Testimony of Company witness Thomas J. Bourassa (Exh. A-3) at 16 and Schedule C-2, page 6.

³² Rebuttal Testimony of Company witness Robert N. Hanford (Exh. A-2) at 6.

³³ Direct Testimony of Company witness Robert N. Hanford (Exh. A-1) at 5-7.

1 allocation was offered only in a fixed amount and was a one-time only opportunity at a fixed price.³⁴
 2 CCWC contends that the Colorado River is already overcommitted as a water source, and future
 3 reductions in CAP water deliveries are a real possibility.³⁵ CCWC asserts that it must plan for its
 4 water supply needs not only for the next year, but for the next several decades and longer.³⁶ CCWC
 5 believes that the acquisition of the additional CAP allocation should be viewed as an “indivisible
 6 whole” that produces benefits to the ratepayers that could not have been obtained had the Company
 7 not paid the \$1.28 million acquisition price, and that the entire acquisition cost is therefore used and
 8 useful.³⁷

9 Staff is in agreement with the Company that the entire acquisition cost of the additional CAP
 10 allocation should be included in rate base, classified as a plant-in-service component of Land and
 11 Land Rights, and not subject to amortization.³⁸ In its Engineering Report on the application, Staff
 12 found that approximately half the requested additional 1,931 acre-feet per year CAP allocation (966
 13 acre-feet) would be used and useful within a five-year timeframe.³⁹ Based on that determination,
 14 Staff is recommending that the Company be allowed recovery of 50 percent of the associated annual
 15 M&I charges.⁴⁰ Staff contends that the full allocation should be included in rate base at this time,
 16 however, because reallocation of CAP water occurs infrequently, and CAP water is oversubscribed.⁴¹
 17 Staff states that it is imperative to secure an additional CAP allotment when it becomes available, and
 18 believes CCWC acted prudently in the \$1.28 million purchase of the additional CAP allocation,
 19 based on the combination of two factors: the CAP reallocation opportunity was for all or nothing of a
 20 fixed amount, and the additional CAP allocation will allow CCWC to limit or eliminate the use of
 21 groundwater to serve its customers.⁴²

22
 23 ³⁴ Company Brief at 11.

24 ³⁵ Company Brief at 12, citing Tr. at 131-133.

25 ³⁶ *Id.*

26 ³⁷ Company Brief at 12-13.

27 ³⁸ Staff Brief at 3, Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 15-18; Company Brief at 11.

28 ³⁹ Direct Testimony of Staff witness Marlin Scott, Jr. (Exh. S-1) at *ii*, and Engineering Report at 11.

⁴⁰ Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 27-28. As discussed in the Operating Income section below, the Company agrees with the operating expense treatment, and RUCO agrees that M&I expenses should be allowed in an amount commensurate with the portion of the additional CAP allocation that is determined to be used and useful.

⁴¹ Staff Brief at 3, citing Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 18.

⁴² *Id.*

1 RUCO disagrees with the recommendations of the Company and Staff, and makes several
 2 arguments against inclusion of the additional CAP allocation in rate base. RUCO argues that the
 3 additional CAP allocation should not be put in rate base at all, because doing so would allow the
 4 Company to expand its service area as requested in Decision No. 68238 (October 25, 2005) for the
 5 benefit of the State Land Department or a developer at the expense of current ratepayers.⁴³ RUCO
 6 argues that if the Company needs a drought buffer, it should “work more diligently to resolve its
 7 long-standing water loss issue.”⁴⁴ RUCO contends that Staff’s growth projections are unreliable,⁴⁵
 8 and that the Company’s demand estimates do not support placing 100 percent of the additional CAP
 9 allocation in rate base.⁴⁶ RUCO states that its witness’ accounting analysis opinion is that the current
 10 used and useful portion of the additional CAP allocation “is only about in the single digits.”⁴⁷ RUCO
 11 recommends, however, that “[i]f the Commission determines that some measure of the additional
 12 CAP allocation is needed for a drought buffer . . . RUCO’s revised recommendation is that no more
 13 than 35% of the additional CAP allocation be treated as land and land rights in a non-depreciable
 14 account.”⁴⁸ RUCO’s arguments are addressed below.

15 Decision No. 68238 Order Preliminary

16 RUCO advances an argument that the additional CAP allocation should be totally excluded
 17 from rate base, because putting it in rate base “would allow the Company to expand its service area
 18 for the benefit of the State Land Department or a developer at the expense of current ratepayers.”⁴⁹
 19 RUCO is referring to Docket No. W-02113A-05-0178. On October 25, 2005, Decision No. 68238 in
 20 that docket granted CCWC an Order Preliminary for a Final Order granting an extension of CCWC’s
 21 CC&N to include approximately 1,300 acres of state trust land located north of the Town of Fountain
 22 Hills, immediately adjacent to the Company’s existing CC&N area.⁵⁰ The Staff Engineering Report
 23 in this case notes that one of the requirements Decision No. 68238, imposed for the issuance of a

24 ⁴³ RUCO Reply Brief at 2.

25 ⁴⁴ *Id.* at 7.

26 ⁴⁵ *Id.* at 3-4.

27 ⁴⁶ *Id.* at 5.

28 ⁴⁷ *Id.* at 7, citing Tr. at 301-02.

⁴⁸ *Id.* at 7.

⁴⁹ *Id.* at 2.

⁵⁰ Decision No. 70608 (November 12, 2008) extended the deadline for compliance with the Order Preliminary deadlines established in Decision No. 68238 to April 25, 2010.

1 Final Order in that docket is for CCWC to demonstrate sufficient water source capacity for its water
 2 system.⁵¹ RUCO charges that the additional CAP allocation at issue in this case is needed not for the
 3 purpose of satisfying the demands of current customers, but instead to provide a 100-year assured
 4 water supply to permit the sale of the state trust land to a private subdivision developer.⁵² RUCO
 5 argues that the Order Preliminary indicated that the Company had sufficient source and storage
 6 capacity to serve up to 18,000 customers,⁵³ and is concerned that ratepayers will bear the full cost of
 7 the additional CAP allocation “while the true beneficiaries, the subdivision developer and/or the
 8 State, receive the benefit.”⁵⁴

9 According to the Company, its request for inclusion of the additional CAP allocation
 10 acquisition costs in rate base was *not based on benefiting* a subdivision developer.⁵⁵ In response to
 11 RUCO’s argument regarding the Order Preliminary requirements, the Company states that in the
 12 event the property covered by the Order Preliminary is developed at some future date, current
 13 customers would actually benefit from the potential expansion, both from the increase of the
 14 customer base over which the Company recovers its cost of service, and from the collection of hook-
 15 up fees from new customers.⁵⁶ Staff’s witness testified that the Order Preliminary’s requirement that
 16 the Company demonstrate an adequate water supply in order to receive a Final Order was only one
 17 item Staff considered in looking at whether the Company’s acquisition of the additional CAP
 18 allocation was prudent.⁵⁷ The witness emphasized that Staff’s main consideration in its prudence
 19

20 ⁵¹ Direct Testimony of Staff Witness Marlin Scott, Jr. (Exh. S-1), Engineering Report at 11. Decision No. 68238 orders
 the following:

21 “IT IS FURTHER ORDERED that, prior to issuance of a Final Order, Chaparral City Water Company,
 22 Inc. shall be required to demonstrate to the satisfaction of the Commission’s Director of Utilities that
 23 the Company is able to meet the water production needs for its system, PWS No. 07-017, for both its
 24 current customer base as well as expected demand for the proposed extension area. Sufficient capacity
 may be demonstrated by filing with Docket control a list of pending or future water sources, their
 anticipated production capacity in gallons per minute, and a time schedule for ADEQ approval of
 construction and operation.”

Decision No. 68238 at 8.

25 ⁵² RUCO Reply Brief at 1-2, citing Decision No. 68238 at 3, fn 2.

26 ⁵³ RUCO Reply Brief at 1. Decision No. 68238 states that “Staff indicated that Chaparral City currently has sufficient
 source and storage capacity to serve up to 18,000 customers.” Decision No. 68238 at 3, Findings of Fact No. 6.

27 ⁵⁴ RUCO Reply Brief at 3.

28 ⁵⁵ Company Reply Brief at 13-1; *see also* Direct Testimony of Company witness Robert N. Hanford (Exh. A-1) at 5-7;
 Company Brief at 12, citing Tr. at 131-133.

⁵⁶ Company Reply Brief at 14.

⁵⁷ Tr. at 337.

1 analysis was ADWR's requirement that the acquisition be an all or nothing purchase.⁵⁸

2 RUCO did not raise this issue in its prefiled testimony in this case, and therefore the factual
3 record on the issue is limited. As stated above, Decision No. 68238 is an Order Preliminary, and not
4 a Final Order. No request for a Final Order has yet been filed, and it therefore remains to be seen
5 whether a Final Order will be considered in Docket No. W-02113A-05-0178. It is therefore
6 inappropriate to base a determination on whether to allow rate base recovery of the additional CAP
7 allocation acquisition cost on the existence of that docket. We agree with the Company that
8 regardless of the outcome in Docket No. W-02113A-05-0178, all its customers will benefit from the
9 additional CAP allocation.

10 Unaccounted-for Water

11 While RUCO recommends inclusion of 35 percent of the additional CAP allocation in rate
12 base as a drought buffer if needed, RUCO simultaneously argues that if the Company needs a drought
13 buffer, it should "work more diligently to resolve its long-standing water loss issue."⁵⁹ RUCO states
14 that in 2007, the Company reported unaccounted-for water of 1,030 acre-feet, or 14 percent⁶⁰ as a
15 result of metering inaccuracies either at the homes of ratepayers or at the CAP canal.⁶¹ RUCO does
16 not agree with Staff the fact that the Company's current CAP allocation was exceeded in 2006 shows
17 a need for the additional CAP allocation.⁶² RUCO argues that "if the Company accounted for the
18 water in excess of the acceptable loss standard (10%), the Company would have an additional 4% or
19 315.5-plus acre-feet available to satisfy the needs of its customers" and "[i]f the Company accounted
20 for unaccounted water there would be no need for additional CAP allocation for drought buffer."⁶³
21 RUCO's position fails to take into account that, as RUCO acknowledges,⁶⁴ the Company's test year
22 unaccounted-for water was not due to "water loss," i.e., leaks, broken mains or maintenance issues.
23 The non-account water issue is likely to be the result of a faulty CAP meter, an issue that the
24

25 ⁵⁸ *Id.*

26 ⁵⁹ RUCO Reply Brief at 7.

27 ⁶⁰ RUCO Brief at 5, citing to Tr. at 62.

28 ⁶¹ *Id.* at 5-6, citing to Tr. at 67, 320.

⁶² RUCO Reply Brief at 6, referring to Direct Testimony of Staff witness Marlin Scott, Jr. (Exh. S-1), Engineering Report at 11.

⁶³ RUCO Reply Brief at 6.

⁶⁴ RUCO Brief at 5-6.

1 Company is working to resolve with the Central Arizona Water Control District.⁶⁵ Staff's
 2 engineering witness testified that CCWC is well-operated, well-maintained and well-managed, and
 3 that CCWC is not ignoring water loss issues.⁶⁶ As the Company points out, resolution of the likely
 4 cause of the unaccounted-for water, a faulty CAP meter, will not result in any additional wet water
 5 for the Company to serve its customers.⁶⁷ We agree with the Company on this point, and find that
 6 RUCO's arguments regarding unaccounted-for water do not justify excluding the additional CAP
 7 allocation from rate base.

8 Staff's Engineering witness states that the Company is aware of its 15.9 percent unaccounted-
 9 for water/water loss amount, and that the Company informed Staff it will be installing its own CAP
 10 water meter at its Shea Water Treatment Plant to determine whether the CAP intake meter is
 11 accurately registering.⁶⁸ Staff recommends that the Company begin a 12-month monitoring exercise
 12 of its water system after the Company completes its own CAP water meter installation.⁶⁹ Staff
 13 further recommends that the Company docket the results of the system monitoring as a compliance
 14 item in this case by March 1, 2010.⁷⁰ Staff recommends that if the reported water loss for the period
 15 from February 1, 2009 through February 1, 2010 is greater than 10 percent, the Company be required
 16 to prepare a report containing a detailed analysis and plan to reduce water loss to 10 percent or less,
 17 or alternatively, if the Company believes it is not cost effective to reduce water loss to less than 10
 18 percent, the Company should be required to submit a detailed cost benefit analysis to support its
 19 opinion.⁷¹ Staff recommends that the Company be required to docket the report or alternative cost
 20 benefit analysis, if required, by April 30, 2010, as a compliance item for this proceeding for review
 21 and certification by Staff, and that in no case should water loss be allowed to remain at 15 percent or
 22 greater.⁷² Staff's recommendations on this issue are reasonable and will be adopted.

23 ...
 24
 25 ⁶⁵ Tr. at 38, 127-131.

⁶⁶ Tr. at 312, 319.

⁶⁷ Company Reply Brief at 13, citing Tr. at 130-31.

⁶⁸ Direct Testimony of Staff Witness Marlin Scott, Jr. (Exh. S-1) at *i*.

⁶⁹ Direct Testimony of Staff Witness Marlin Scott, Jr. (Exh. S-1) at *i*.

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

1 Need for the Additional CAP Allocation

2 RUCO contends that CCWC's current water supplies, without the additional CAP allocation,
 3 are sufficient to meet the Company's its current and future demand.⁷³ At the same time, RUCO
 4 argues that if it is determined that some measure of the additional CAP allocation is needed to
 5 provide a drought buffer in the event of future curtailments of CAP water, only the used and useful
 6 portion of the additional CAP allocation should be included in rate base,⁷⁴ and that a current absence
 7 of growth in CCWC's service area and CCWC's unaccounted-for water should be considered in
 8 determining the amount of the additional CAP allocation that is used and useful.⁷⁵ RUCO
 9 recommends that "no more than 35%" of the additional CAP allocation be treated as Staff and the
 10 Company propose.⁷⁶ RUCO contends that the Company's demand estimates do not support placing
 11 100 percent of the additional CAP allocation in rate base,⁷⁷ arguing on brief that "by Mr. Hanford's
 12 optimistic estimates, 18.17% of the additional CAP allocation will be needed by 2010 and 31.43% by
 13 2016."⁷⁸ RUCO also expresses disagreement with Staff's projections, arguing that the growth
 14 projections Staff relied on in its determination that 50 percent of the additional CAP allocation is
 15 used and useful do not consider current economic circumstances in the Company's service territory.⁷⁹
 16 RUCO argues that to reach Staff's projections, CCWC would have to establish 334 new accounts per
 17 year from 2007 through 2012,⁸⁰ but provided no alternative growth projections or evidence to
 18 support its claim other than the accounting analysis opinion of RUCO's witness that the current used
 19 and useful portion of the additional CAP allocation "is only about in the single digits."⁸¹ RUCO's
 20 recommendation on this issue that "no more than 35 percent" of the additional CAP allocation should
 21 be allowed in rate base is difficult to reconcile with its arguments.

22 The Company states that if it is denied recovery for the additional CAP allocation, the
 23 Company would receive a message that it should rely on groundwater pumping if shortages occur,

24 ⁷³ RUCO Reply Brief at 7.

25 ⁷⁴ *Id.*

26 ⁷⁵ *Id.*

27 ⁷⁶ *Id.*

28 ⁷⁷ *Id.* at 5.

⁷⁸ *Id.*, citing Tr. at 83-84.

⁷⁹ RUCO Reply Brief at 3-4.

⁸⁰ *Id.* at 4, referring to Direct Testimony of Staff Witness Marlin Scott, Jr. (Exh. S-1), Engineering Report at 5.

⁸¹ *Id.* at 7, citing Tr. at 301-02.

1 instead of looking out for the long-term interests of its customers and the community of Fountain
 2 Hills by obtaining additional CAP water supplies.⁸² RUCO argues that since the Company intends to
 3 file a rate case again in two to three years,⁸³ it is not imperative to include 100 percent of the
 4 additional CAP allocation in rate base.⁸⁴ The Company explains that if it is not accorded reasonable
 5 cost recovery for its purchase of the additional CAP allocation, it is unlikely that it will be able to
 6 keep the right that it believes it prudently acquired for the benefit of its customers.⁸⁵ The Company's
 7 witnesses testified that the Company has made an investment and expects a return on the investment,
 8 and that if full recovery of the acquisition costs is not allowed, the Company will be faced with a
 9 choice of how to otherwise recoup its investment.⁸⁶ If denied regulatory recovery of the investment
 10 made on behalf of its ratepayers, according to the Company, its choices will be to either: (1) retain
 11 the additional allocation and look for entities who wish to enter into wholesale water delivery
 12 arrangements from it; or (2) exchange or relinquish the additional acquisition and get its acquisition
 13 payment back.⁸⁷

14 The application process for the available additional CAP allocations was a competitive one
 15 that considered the applicants' needs under the Third Management Plan.⁸⁸ Of fifty-three applicants
 16 seeking a portion of the 65,647 acre-feet of CAP water available for reallocation, only twenty-six
 17 applicants were considered in the first round, and CCWC was one of twenty who were subsequently
 18 given the opportunity to purchase an additional CAP allocation.⁸⁹ Based on the factual record in this
 19 case, we agree with Staff's reasoned recommendation, agreed to by the Company, that the entire
 20 acquisition cost of the additional CAP allocation be included in rate base, classified as a plant-in-
 21 service component of Land and Land Rights, and not subject to amortization. Our determination is
 22 based on the Company's need to provide its customers continued access to adequate renewable water
 23 supplies, and on the fact that CCWC acted prudently under the circumstances in the December, 2007,
 24

25 ⁸² Rebuttal Testimony of Company witness Robert J. Sprowls (Exh. A-8) at 5.

26 ⁸³ RUCO Reply Brief at 6, citing Tr. at 121.

27 ⁸⁴ RUCO Reply Brief at 6.

28 ⁸⁵ Company Reply Brief at 12.

⁸⁶ Direct Testimony of Company witness Robert N. Hanford (Exh. A-1) at 7.

⁸⁷ Direct Testimony of Company witness Robert N. Hanford (Exh. A-1) at 7.

⁸⁸ Direct Testimony of Staff witness Marlin Scott, Jr. (Exh. S-1), Engineering Report at 11; Tr. at 325-327.

⁸⁹ *Id.*

1 \$1.28 million purchase of the additional CAP allocation.

2 **C. Working Capital**

3 The Company did not prepare a lead/lag study to quantify its cash working capital
4 requirement.⁹⁰ Staff contends that in the absence of the cash working capital component of a lead/lag
5 study, it is inappropriate to consider other components of working capital, and therefore disallowed
6 prepayments and materials and supplies inventory from rate base.⁹¹ Staff's proposed adjustment to
7 rate base removes (1) Unamortized Debt Issuance Costs in the amount of \$424,010, (2) Prepayments
8 in the amount of \$192,485, and (3) Materials and Supplies Inventory in the amount of \$14,521, for a
9 total reduction to rate base of \$631,016.⁹²

10 The Company argues that there is no requirement that it prepare a lead/lag study, and that it
11 adopted the lead/lag study prepared by RUCO, along with the negative working capital allowance
12 RUCO derived from its study.⁹³ RUCO's recommended total working capital is \$95,400, which
13 consists of a negative Cash Working Capital allowance of (\$111,606), Prepayments in the amount of
14 \$192,485, and Materials and Supplies in the amount of \$14,521.⁹⁴ The Company is critical of the fact
15 that Staff did not analyze RUCO's lead/lag study, which was presented in RUCO's direct testimony,
16 and argues that because Staff did not challenge RUCO's lead/lag study, it should therefore be
17 adopted in lieu of Staff's disallowances.⁹⁵ Staff responds that if the Company had prepared a lead/lag
18 study and submitted it with its application, Staff would have had an opportunity to review it and
19 make a recommendation on it.⁹⁶

20 The Company correctly states that Unamortized Debt Issuance Costs are actually not a part of
21 working capital.⁹⁷ Staff's witness testified at the hearing that while they are not, they should be
22 removed from rate base nonetheless, because they are a below-the-line expense, and similar to

23 _____
24 ⁹⁰ A company's working capital requirement represents the amount of cash the company must have on hand to cover any
25 differences in the time period between when revenues are received and expenses must be paid. The most accurate way to
26 measure the working capital requirement is via a lead/lag study. The lead/lag study measures the actual lead and lag days
27 attributable to the individual revenue and expenses. Staff Brief at 4.

28 ⁹¹ Staff Brief at 5, citing Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 23.

⁹² Staff Brief at 5, citing Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 22.

⁹³ Company Reply Brief at 1.

⁹⁴ Direct Testimony of RUCO witness Timothy J. Coley (Exh. R-8) at 23-24.

⁹⁵ Company Reply Brief at 1.

⁹⁶ Staff Reply Brief at 2.

⁹⁷ Company Reply Brief at 2.

1 interest, are amortized over the life of the debt, and adds that it would also be improper to allow them
 2 as operating expenses.⁹⁸ The Company disagrees with Staff's assessment that the Unamortized Debt
 3 Issuance Costs are a below-the-line expense. The Company argues that no evidence was presented
 4 that the costs were improper or unreasonable, calls the idea "nonsensical,"⁹⁹ and argues that if
 5 Unamortized Debt Issuance Costs are removed from rate base, Staff should have included them in
 6 calculating the Company's cost of debt, but did not.¹⁰⁰ However, the Company provided no evidence
 7 controverting Staff's expert accounting testimony that Unamortized Debt Issuance Costs should be
 8 removed from rate base.¹⁰¹

9 A lead/lag study is the most accurate and appropriate means of measuring the working capital
 10 requirements of a utility of CCWC's size. The Company could have prepared and included with the
 11 application a lead/lag study to support its request for recovery of working capital allowance. If it had,
 12 all parties would have had adequate time for analysis and discovery related to the lead/lag study. The
 13 Company chose not to do so. In the absence of the cash working capital component of a lead/lag
 14 study, it is inappropriate to consider other components of working capital. The Company chose not
 15 to provide a lead/lag study for analysis, but wishes the Commission to allow recovery of working
 16 capital components nonetheless. The fact that a lead/lag study was presented by RUCO, and that
 17 Staff did not challenge it, does not compel its adoption. Neither does the fact that a lead/lag study
 18 was presented by RUCO compel the rejection of Staff's proposed adjustments. RUCO's accounting
 19 witness testified that "[s]hould the Commission reject RUCO's first recommendation, RUCO's
 20 second recommendation would be to disallow the Company the opportunity to recover materials &
 21 supplies and prepayments for which it seeks recovery, since those two items are components of a
 22 working capital allowance adjustment."¹⁰² Staff's proposed disallowance of \$192,485 in
 23 Prepayments and \$14,521 in Materials and Supplies Inventory is appropriate, and will be adopted. In
 24

25 ⁹⁸ Tr. at 375-381.

26 ⁹⁹ Company Brief at 2.

27 ¹⁰⁰ Company Reply Brief at 14.

28 ¹⁰¹ The Company may be correct that the Unamortized Debt Issuance Costs should have been included in calculating the cost of debt, but if so, the Company also should have included them in its calculation. As discussed below, the parties are in general agreement on the cost of debt, with the cost of debt adopted in this proceeding slightly higher than that proposed by the Company.

¹⁰² RUCO's Direct Testimony of RUCO witness Timothy J. Coley (Exh. R-8) at 24.

1 addition, the record supports removal of \$424,010 in Unamortized Debt Issuance Costs from rate
2 base. A total reduction to rate base of \$631,016 is reasonable and will be adopted.

3 Staff recommends that the Company be ordered to perform and submit a lead/lag study in
4 conjunction with its next rate adjustment request application in order to meet the sufficiency
5 requirements of that filing. There was no objection to that recommendation, which is reasonable and
6 will be adopted.

7 **D. CIAC Amortization Rate**

8 The Company and Staff agree regarding the method for amortization of Contributions in Aid
9 of Construction ("CIAC"),¹⁰³ which includes computation of a composite CIAC amortization rate
10 based on depreciation expense.¹⁰⁴ RUCO objects to the method, and recommends instead that the
11 Company "be required to utilize the amortization rate established in the prior case or a rate
12 established based on CIAC amounts and the corresponding plant depreciation rates to insure that
13 plant and CIAC are properly matched."¹⁰⁵ Decision No. 68176 did not establish a specific CIAC
14 amortization rate to be used on a going forward basis. The Company is correct that the reason
15 specific CIAC amortization rates are not set on a going forward basis is that the amortization rate is
16 expected to be adjusted to match the composite depreciation rate for each year, and using a fixed
17 composite rate for amortization of CIAC over lengthy intervals between rate cases can result in
18 significant mismatches between net plant-in-service and net CIAC.¹⁰⁶ Using the CIAC amortization
19 rate utilized in that proceeding would not meet RUCO's goal of insuring that plant and CIAC are
20 properly matched, whereas the methodology used by the Company and Staff in this proceeding does.
21 The methodology used by the Company and Staff, which is based on CIAC amounts, depreciable
22 plant, and depreciation expense in this case, properly matches net plant-in-service and net CIAC, and
23 will be adopted.

24 **E. Accumulated Depreciation**

25 Staff proposes an adjustment to reduce Accumulated Depreciation by \$2,031,950 from the
26

27 ¹⁰³ Company Reply Brief at 14.

¹⁰⁴ Staff Reply Brief at 2-3.

¹⁰⁵ RUCO Reply Brief at 12.

28 ¹⁰⁶ Company Brief at 15.

1 Company's amount of \$15,877,022 to reflect Staff's Accumulated Depreciation of \$13,845,072.¹⁰⁷
 2 Staff states that the reason for the difference is related to Staff's use of the 4.0 percent General Office
 3 plant allocation factor and the plant additions and retirements of wells and other plant.¹⁰⁸ Staff
 4 contends that the 4.0 percent allocation factor is more correctly matched to the test year.¹⁰⁹ The
 5 Company agrees, and states that it accepted the 2.8 percent allocation factor proposed by RUCO as a
 6 compromise and to help minimize issues, even though it would result in a lower rate base and lower
 7 rates.¹¹⁰ RUCO did not address the issue on brief. Staff's adjustment is reasonable and will be
 8 adopted.

9 **IV. FAIR VALUE RATE BASE**

10 Based on the foregoing discussion, we adopt an adjusted OCRB for the Company of
 11 \$21,370,877, and an adjusted RCND of \$32,181,951, weighted 50/50, for a FVRB of \$26,776,414.

12 **V. OPERATING INCOME ISSUES**

13 **A. Property Tax Expense Calculation**

14 The Company and Staff propose to follow recent Commission Decisions to use adjusted test-
 15 year revenues in the application of the Arizona Department of Revenue ("ADOR") formula in order
 16 to determine allowed property tax expense.¹¹¹ As in many past rate cases, RUCO disagrees with this
 17 methodology, and proposes the use of either the "ADOR methodology of averaging three historical
 18 years, or RUCO's new alternative of adding the last known and measurable property tax expense and
 19 the property tax expense associated with the additional increment of adjusted proposed revenue
 20 approved by the Commission."¹¹² RUCO attached as an exhibit to its closing brief a new schedule
 21 showing the effect of RUCO's new alternative methodology on the proposed revenues of the
 22 parties.¹¹³ RUCO states that the Company collected nearly \$300,000 more property tax expense than
 23 it actually paid in the three years from 2006 to 2008, due to a decrease in the Company's property tax
 24

25 ¹⁰⁷ Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 20.

26 ¹⁰⁸ *Id.*

27 ¹⁰⁹ *Id.*

28 ¹¹⁰ Company Reply Brief at 3.

¹¹¹ Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) Schedule MEM-25; Rebuttal Testimony of Company witness Thomas J. Bourassa (Exh. A-5) at 17.

¹¹² RUCO Reply Brief at 12.

¹¹³ RUCO Brief, Exhibit A.

1 assessment, which RUCO states was “due in great part to the reduction in tax rate and the tax
 2 assessment ratio, adopted by the Arizona Legislature in HB 2779 and codified at A.R.S. § 41-
 3 15002.”¹¹⁴ RUCO argues that if the methodology it advocates had been used in the prior rate case,
 4 averaging the three prior years of reported gross revenue by a factor of two, would have resulted in
 5 \$19,000 less in allowed property tax expense.¹¹⁵ The Company disagrees with RUCO’s claim that it
 6 has overcollected property tax expense. The Company argues that having consistently failed to earn
 7 sufficient revenue to earn its authorized rate of return every year since the current rates went into
 8 effect, the Company has not over-recovered anything, rendering RUCO’s argument illusory.¹¹⁶ The
 9 Company contends that RUCO’s claim demonstrates the danger of singling out one expense to
 10 evaluate over-or under-recovery, and that RUCO’s contention that the Company “overcollected”
 11 property taxes is both misleading and untrue.¹¹⁷ Staff argues that because RUCO has provided no
 12 other substantive basis for deviating from the methodology the Commission has consistently utilized
 13 in calculating property tax expense, that the Commission should adopt the methodology used by the
 14 Company and RUCO in this case.¹¹⁸

15 We agree with RUCO that the difference in the estimated property tax in the last rate case and
 16 the amount of property tax paid in the years from 2006 to 2008 was due largely to tax rate and tax
 17 assessment ratio changes, and not to the methodology used to estimate the Company’s property tax
 18 expense.¹¹⁹ And we agree with the Company that looking at a single expense allowance from a prior
 19 rate case in order to judge expense under- or over-collection, can be misleading and should be
 20 avoided, as should any other single-issue ratemaking exercise. Unlike many test year expenses, a
 21 determination of property tax expense involves a forward-looking estimation. Using the revenue-
 22 dependent methodology based on the ADOR formula that has repeatedly been approved by the
 23 Commission, Staff and the Company utilized adjusted test-year revenues in the application of the
 24 ADOR formula to estimate the Company’s future property tax expense, in order to determine an
 25

26 ¹¹⁴ RUCO Brief at 12, citing Surrebuttal Testimony of RUCO witness Timothy J. Coley (Exh. R-9) at 31-32.

27 ¹¹⁵ RUCO Brief at 12, citing Surrebuttal Testimony of RUCO witness Timothy J. Coley (Exh. R-9) at 38-41.

28 ¹¹⁶ Company Reply Brief at 15.

¹¹⁷ Company Brief at 17, citing Tr. at 158-59.

¹¹⁸ Staff Reply Brief at 9.

¹¹⁹ RUCO Brief at 12.

1 appropriate allowed expense level based on that estimation. Staff's method calculates the appropriate
2 level of ongoing property tax expense for the revenue requirement by including a component for
3 property taxes that reflects known assessment ratios and tax rates in the gross revenue conversion
4 factor.¹²⁰ RUCO's arguments in this case do not provide a basis for requiring any changes to the
5 simple, accurate, reliable and reasonable methodology we have approved in past cases and again
6 adopt in this case.

7 **B. Expense Normalization**

8 Staff proposes adjustments to normalize test year Chemical Expenses and Repairs and
9 Maintenance Expenses. The Company opposes both normalization adjustments.

10 Chemical Expenses

11 Staff's proposed normalization of Chemical Expenses would reduce the test year expense
12 level from \$127,457 to \$99,827, which is the three-year average of the Company's chemical expenses
13 for 2004, 2005, and the test year, 2006. The expenses in 2004 were \$66,210; in 2005, \$105,814; and
14 in 2006, \$127,457. Staff asserts that the normalization is appropriate because the Company's
15 chemical expenses have more than doubled subsequent to the Company's prior test year of 2003, and
16 because there were two large invoices totaling approximately \$17,000 for chemicals delivered in
17 December, 2006 that Staff believes were to be used post test year.¹²¹ Staff asserts that the December
18 2006 invoices were for deliveries not made on a monthly basis, but over longer time periods, and that
19 Staff believed those chemicals were for use in the following year, not the test year, and should
20 therefore not have been included in test year expenses.¹²² Staff's witness also testified that he knew
21 that a new treatment plant had come online during the three-year time period he used for the
22 normalization averaging, so that he was aware that chemical expenses would increase.¹²³ The
23 Company disagrees with the normalization adjustment, contending that the test year is presumed to
24 be normal, and adjustments should be based on known and measurable changes.¹²⁴ We agree. In this
25 instance, it was known to Staff that due to the new treatment plant, chemical expenses would have

26 ¹²⁰ Staff Brief at 10.

27 ¹²¹ Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 33; Tr. at 384-85.

28 ¹²² Tr. at 384-85.

¹²³ *Id.*

¹²⁴ Company Brief at 19.

1 increased.¹²⁵ In regard to the December 2006 invoices, the record does not reflect any inquiry
 2 demonstrating that Staff's assumption that the chemicals were not properly a test year expense was
 3 correct. If so, it may have been proper to exclude them from test year expenses, but that is not what
 4 Staff proposed. Even if Staff had shown that the invoice amounts should have been excluded, the
 5 exclusion would not have justified a normalization adjustment. Because the record does not support
 6 the normalization of Chemical Expense proposed by Staff, the actual test year expense will be
 7 allowed instead.

8 Repairs and Maintenance Expense

9 Staff proposes a normalization adjustment to the Company's Repair and Maintenance
 10 Expense reducing the test year expense from \$104,609 to \$91,134. Staff believes that the fluctuation
 11 in this expense account, from \$96,152 in 2004, to \$72,640 in 2005, to \$104,609 in the test year,
 12 called for a normalization adjustment, based on Staff's opinion that there "does not appear to be any
 13 upward trending in these expenses."¹²⁶ In addition, Staff proposes exclusion of \$5,543 of test year
 14 expenses booked in this account for the Company's payments to Pepsi Cola Company of Dallas for
 15 beverages for the Company's employees. The Company does not dispute that the \$5,543 should be
 16 disallowed. We agree with Staff that this is an expense that should be borne by the shareholders, not
 17 the ratepayers, and will not be allowed. The \$5,543 disallowance to test year expenses brings the test
 18 year level of repair and maintenance expense down to a level close to the 2004 level of expense,
 19 which, based on the evidence presented, is a reasonable level. Because the record does not support
 20 Staff's proposed normalization of Repairs and Maintenance Expense, the actual test year expense,
 21 less Staff's proposed disallowance of \$5,543, will be allowed.

22 **C. Deferral of CAP M&I Charges**

23 The Company and Staff agree that the Company should be allowed recovery of 50 percent of
 24 the CAP M&I charges related to the additional CAP allocation, or \$20,306, as an operating expense,
 25 based on Staff's position that only 50 percent of the additional CAP allocation is used and useful at
 26 this time, and that 50 percent of the charges should be deferred.¹²⁷ Staff filed in this docket proposed

27 ¹²⁵ Tr. at 384-85.

28 ¹²⁶ Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 34; Staff Reply Brief at 4.

¹²⁷ Company Brief at 11, 20-21; Staff Reply Brief at 4.

1 accounting order language which would allow the deferral of the remaining 50 percent of the M&I
 2 charges.¹²⁸ RUCO states that if it is determined that some portion of the additional CAP allocation is
 3 used and useful, a commensurate portion of the associated annual water service capital charge should
 4 be included as an M&I expense in this case.¹²⁹ RUCO does not oppose the accounting order
 5 language as to form.¹³⁰ The Company disagrees with language in Staff's accounting order proposal
 6 allowing the Company a 36 month deferral period,¹³¹ and included its own proposed accounting order
 7 language as an attachment to its closing brief.¹³²

8 The Company and Staff disagree on two issues related to the deferral: (1) whether the
 9 Company should be allowed to defer interest or other carrying charges, and (2) whether the deferral
 10 should have a time limitation.

11 The Company asserts that until the recovery of interest or carrying costs can be considered in
 12 a future rate case, the Company should be allowed to accrue reasonable carrying costs.¹³³ Staff
 13 contends that it is inappropriate to allow the Company to accrue interest on the deferral, because 50
 14 percent of the M&I charges are not currently used and useful.¹³⁴ As Staff notes, the interest and
 15 timeframe requirements of Staff's proposal are consistent with other Commission Accounting
 16 Orders.¹³⁵ Staff's language "excluding any interest or other carrying charges" is consistent with our
 17 other Accounting Orders and will therefore be adopted.

18 The Company contends that there is no reason for "preset, artificial limits" on the deferral
 19 period.¹³⁶ Staff argues that without a specified timeframe, the Company would be able to defer the
 20 charges indefinitely.¹³⁷ Staff contends that 36 months is a reasonable timeframe for the deferral
 21 period, and points out that its proposal also includes a provision allowing the Company to continue
 22 the deferral beyond its evaluation in the Company's next rate case, such that the Staff proposal does
 23

24 ¹²⁸ Staff Proposed Accounting Order Language docketed on January 6, 2009.

¹²⁹ RUCO Reply Brief at 7.

25 ¹³⁰ RUCO Response to Proposed Accounting Order, docketed on January 13, 2009.

¹³¹ Company Brief at 21-22 and Exhibit 2.

26 ¹³² Company Brief at Exhibit 2.

¹³³ Company Brief at 21-22 and Exhibit 2.

27 ¹³⁴ Staff Reply Brief at 5.

¹³⁵ *Id.*

28 ¹³⁶ Company Brief at 21-22 and Exhibit 2.

¹³⁷ Staff Reply Brief at 5.

1 not specifically limit the deferral to 36 months.¹³⁸ Staff states that it proposed the 36 month
 2 timeframe in order to permit time for Staff to evaluate whether the Company is properly accounting
 3 for the deferral, and also to determine if all or a portion of the deferred charges are used and useful,
 4 and therefore eligible to be placed in rates.¹³⁹ For the reasons provided by Staff, we agree that a
 5 definite timeframe should be placed on the deferral period, and find that under the circumstances of
 6 this case, a 48 month period is reasonable.

7 **D. Rate Case Expense**

8 The Company requests authority to recover rate case expense associated with this case in the
 9 amount of \$280,000. The Company states that it based its request primarily on the \$285,000 amount
 10 awarded in its last rate proceeding, and that it has incurred more than \$280,000 in this proceeding.¹⁴⁰
 11 RUCO did not brief the issue of rate case expense for this case. Staff proposes that the Company be
 12 allowed to recover no more than \$150,000 in rate case expense for this proceeding, arguing that
 13 \$150,000 in rate case expense is similar to amounts the Commission has allowed comparably-sized
 14 utilities to recover through just and reasonable rates.¹⁴¹ Staff recommends that rate case expense be
 15 normalized, instead of amortized.¹⁴² The Company argues that Staff's opposition to the Company's
 16 request for this proceeding is not supported by the evidence, because Staff gave no consideration to
 17 the specifics of this rate case, to the rate case process, or to the similar rate case expense awards
 18 relied on by the Company, and because Staff could not provide specifics regarding the cases its
 19 witness relied on in reaching his recommendation.¹⁴³ The Company requests that if its rate case
 20 expense recovery is normalized, as Staff recommends, rather than amortized, that it be granted
 21 authority to institute a surcharge instead "to ensure that recovery actually occurs."¹⁴⁴ Based on our
 22 review of the record, we find that it is reasonable to allow recovery of \$280,000 for the expenses
 23 incurred by the Company in this proceeding. We agree with Staff that because rate case expense is a
 24

25 ¹³⁸ *Id.*

26 ¹³⁹ *Id.*

27 ¹⁴⁰ Company Brief at 22, citing Rebuttal Testimony of Company witness Thomas J. Bourassa (Exh. A-5) at 15 and
 Rebuttal Testimony of Company witness Robert N. Hanford (Exh. A-2) at 10.

28 ¹⁴¹ Staff Brief at 8.

¹⁴² *Id.*

¹⁴³ Company Brief at 24, citing Tr. at 390-98.

¹⁴⁴ Company Reply Brief at 6.

1 recurring expense, normalization is a more appropriate treatment than amortization, and that a
 2 surcharge for recovery of rate case expense would be inappropriate. The \$280,000 allowed rate case
 3 expense related to this proceeding will therefore be normalized over three years.

4 **E. Appeal and Remand Rate Case Expense**

5 In addition to the Company's requested recovery of rate case expenses associated with this
 6 proceeding, the Company has requested recovery in this docket of its rate case expenses associated
 7 with the Remand Proceeding, as allowed by Decision No. 70441.¹⁴⁵ The Company originally
 8 requested recovery of \$258,111 of the \$500,000 of rate case expense it incurred in its appeal of
 9 Decision No. 68176 and the Remand Proceeding, which included expert witness fees, copying,
 10 mailing and publication costs, and discounted legal fees.¹⁴⁶ The Company currently requests
 11 recovery of \$100,000 of these expenses through operating expenses, together with the \$280,000 in
 12 expenses associated with this proceeding, discussed above, for a total recovery of \$380,000,
 13 amortized over three years, resulting in a total annual expense of \$126,667 reflected in the revenue
 14 requirement for this case.¹⁴⁷ Staff recommends that the Company be permitted to recover \$100,000
 15 in rate case expense related to the Remand Proceeding, normalized over a three year period, which,
 16 with its recommendation of recovery of \$150,000 related to the current proceeding, would result in
 17 total rate case expense of \$250,000, normalized over a three year period, for a total annual rate case
 18 expense of \$83,333 reflected in the revenue requirement for this case.¹⁴⁸ RUCO recommends denial
 19 of any rate case expense recovery related to the Company's appeal of Decision No. 68176 and the
 20 Remand Proceeding, and RUCO's final schedules show total annual rate case expense of \$93,333
 21 reflected in the revenue requirement for this case.¹⁴⁹

22
 23 RUCO argues that the Company's request for legal fees for the appeal and remand of
 24 Decision No. 68176 should be denied "as a matter of law and public policy."¹⁵⁰ RUCO argues that
 25

26 ¹⁴⁵ Decision No. 70441 at 43.

¹⁴⁶ Supplemental Direct Testimony of Company witness Thomas J. Bourassa (Exh. A-4) at 2-7.

27 ¹⁴⁷ Company Reply Brief at 6.

¹⁴⁸ Staff Brief at 7-8.

¹⁴⁹ RUCO Final Schedule TJC-27.

28 ¹⁵⁰ RUCO Reply Brief at 12.

1 “[a]lthough the appeal and remand corrected the method by which the Commission determined
 2 FVRB rate of return, the Company pursued the appeal to obtain additional operating income for the
 3 benefit of its shareholders,”¹⁵¹ and contends that the shareholders should therefore bear the costs
 4 associated with that lawsuit, and the Company should “pay the costs for its business decision to
 5 pursue an appeal.”¹⁵² RUCO argues that “[p]ermitting the Company to recover its rate case expense
 6 on a lawsuit to benefit shareholders would leave the utilities with the expectation that they can pursue
 7 any lawsuit with no worry of the costs associated therewith because captive ratepayers will pick up
 8 the tab.”¹⁵³

9
 10 The Company contends that it is in the public interest to ensure the legality of Commission
 11 Decisions, and therefore the Company should not bear the entire burden of the expense it incurred to
 12 appeal a Decision for which the Company was not responsible, and which the court found
 13 unlawful.¹⁵⁴ The Company also states that contrary to RUCO’s assertion that a utility “can pursue
 14 any lawsuit with no worry of the costs,” a utility has no expectation of any expense recovery unless it
 15 prevails in its appeal, and that even if a Company is successful, full recovery of expenses is
 16 unlikely.¹⁵⁵

17 RUCO advances the argument that that Arizona law does not permit recovery of attorney’s
 18 fees on remand, citing A.R.S. § 12-348 and *Columbia Parcar Corp. v. Arizona Dept. of*
 19 *Transportation*.¹⁵⁶ *Columbia Parcar* held that plaintiffs did not prevail in adjudication “on the
 20 merits” on judicial review by securing reversal and remand for new hearing on procedural grounds,
 21 and thus were not entitled to award of fees. In *Columbia Parcar*, in the administrative proceeding
 22 leading to the appeal, plaintiffs were not allowed to present evidence on statutory requirements
 23 related to their claim.¹⁵⁷ The facts of *Columbia Parcar* are therefore distinguishable from the facts in
 24

25 ¹⁵¹ RUCO Brief at 11.

26 ¹⁵² *Id.*

27 ¹⁵³ *Id.* 11.

28 ¹⁵⁴ Company Brief at 24.

¹⁵⁵ Company Reply Brief at 16.

¹⁵⁶ RUCO Brief at 10, citing *Columbia Parcar Corp. v. Arizona Dept. of Transportation*, 193 Ariz. 181, 971 P.2d 1042 (App. 1999).

¹⁵⁷ *Columbia Parcar*, 193 Ariz. at 183, 971 P.2d at 1043.

1 this case, as CCWC did not secure its remand of Decision No. 68176 on procedural grounds, but
 2 because it prevailed on the merits of its appeal of a specific ratemaking issue. We also agree with the
 3 Company that the statute cited by RUCO does not apply to this case, as A.R.S. § 12-348(H)(1) does
 4 not apply to actions "to establish or fix a rate."¹⁵⁸

5 Although we find that the Commission has authority to award attorneys fees to the Company
 6 for the appeal and the remand proceeding, we decline to do under these circumstances. The
 7 Company spent more than \$500,000 to recover an additional \$12,000 in operating income. While no
 8 one disputes the Company's right to pursue whatever legal recourse it wants to pursue, we believe
 9 that Company should maintain a proper perspective of the costs and benefits associated therewith. In
 10 order to ensure the Company undertakes the appropriate analysis of the risks and benefits of
 11 litigation, we will not allow the Company to impose the costs of the appeal upon captive ratepayers.
 12

13 F. Operating Income Summary

14
 15 With the adjustments discussed above, we find the Company's test year operating expenses to
 16 be \$6,561,825, on adjusted test year revenues of \$7,505,010, for adjusted test year operating income
 17 of \$943,185.

18 VI. COST OF CAPITAL

19
 20 The parties to this case recommend a rate of return for the Company as follows: CCWC, 9.96
 21 percent; RUCO, 6.38 percent;¹⁵⁹ and Staff, 7.6 percent.¹⁶⁰ For the reasons discussed below, we adopt
 22 a FVROR for the Company of 7.52 percent.

23
 24 ¹⁵⁸ A.R.S. § 12-348(H)(1) provides:

25 This section does not:

- 26 1. Apply to an action arising from a proceeding before this state or a city, town or county in which
 27 the role of this state or a city, town or county was to determine the eligibility or entitlement of an
 individual to a monetary benefit or its equivalent, to adjudicate a dispute or issue between private
 parties or to establish or fix a rate.

28 ¹⁵⁹ RUCO Final Schedule TJC-36.

¹⁶⁰ Staff Final Schedule PMC-2.

1 **A. Capital Structure and Cost of Debt**

2 Capital Structure

3 The parties are generally in agreement regarding CCWC's capital structure. The Company
4 proposes a capital structure consisting of 3.97 percent short-term debt, 19.45 percent long-term debt,
5 and 76.58 percent equity. RUCO recommends a capital structure comprised of 4.08 percent short-
6 term debt, 19.17 percent long-term debt, and 76.75 percent common equity. Staff proposes a capital
7 structure of 75.6 percent equity and 24.4 percent debt. The minor differences in the parties'
8 recommendations are attributable to the Company's use of the capital structure at the end of the test
9 year, while Staff and RUCO used a more recent capital structure.¹⁶¹ Based on the parties' proposals,
10 we find that a capital structure of 24 percent debt and 76 percent equity is reasonable for the
11 Company in this case.

12 Cost of Debt

13 The Company proposes a cost of short-term debt of 2.88 percent, which it based on the
14 London Inter-Bank Offered Rate ("LIBOR") reported on November 21, 2008.¹⁶² CCWC's short term
15 debt is provided by its parent, American States Water Company, subject to variable interest rates
16 based on the LIBOR.¹⁶³ CCWC's proposed cost of long-term debt, 5.33 percent, is based on the end
17 of test year interest rate on its low-cost bonds issued in 1997,¹⁶⁴ for an overall cost of debt of 4.92
18 percent.¹⁶⁵ RUCO recommends a cost of short-term debt of 2.71 percent, and a cost of long-term
19 debt of 5.34 percent. Staff proposes a composite cost of long-term and short-term debt of 5.0 percent,
20 which takes into account changes to the Company's long-term debt occurring after the test year.¹⁶⁶
21 Based on the parties' proposals, we find that the 5.0 percent composite cost of debt recommended by
22 Staff is reasonable, and will adopt it.

23 ...

24 ...

25
26 ¹⁶¹ See Cost of Capital ("COC") Rejoinder Testimony of Company witness Thomas J. Bourassa (Exh. A-21) at 4-5.

¹⁶² Company COC Brief ("Brief") at 31.

¹⁶³ *Id.*

¹⁶⁴ See Company Amended Final Sched. D-2.

¹⁶⁵ Staff COC Brief at 2.

¹⁶⁶ Staff Final Sched. PMC-10.

1 **B. Cost of Equity**

2 Using the DCF and CAPM models, the Company's cost of capital witness estimated the
3 Company's cost of equity to be 12.7 percent. The Company states that although it believes its current
4 cost of equity is 12.7 percent, it has requested a cost of equity of 11.5 percent in order to minimize
5 disputes.¹⁶⁷ Staff's cost of equity estimate is 10.1 percent.¹⁶⁸ RUCO's unadjusted cost of equity
6 estimate is 8.83 percent.¹⁶⁹

7
8 While the Company and Staff used the same six publicly traded water companies as a sample
9 group in their cost of equity analyses, RUCO's sample group differed. The Company disagrees with
10 the group of publicly traded utilities RUCO used to estimate CCWC's cost of equity. In particular,
11 CCWC disagrees with RUCO's substitution of Southwest Water Company for Connecticut Water
12 Service, Middlesex Water Company, and SJW Corporation. RUCO asserts that Southwest Water
13 Company is an appropriate comparable company because American States Water, CCWC's parent
14 company, offers nearly identical service as Southwest Water Company, including unregulated
15 services, and has an identical risk as Southwest Water Company, demonstrated by the fact that the
16 two companies share the same market beta¹⁷⁰ of 1.05, as reported in Value Line Utility Reports.¹⁷¹
17 CCWC argues that Southwest Water Company is not comparable to either CCWC or to the publicly
18 traded water utilities in the sample group used by CCWC and Staff in their cost of equity estimates.
19 CCWC states that according to AUS Utility Reports (November 2008) only 45 percent of Southwest
20 Water Company's revenues are derived from regulated activities, whereas four of the six water
21 utilities used by CCWC and Staff have at least 90 percent of their revenue derived from regulated
22 activities, and the remaining two have 82 percent and 85 percent of their revenues derived from
23 regulated activities.¹⁷² CCWC argues that in comparison to Southwest Water's 45 percent of

24
25 ¹⁶⁷ Company COC Brief at 2.

26 ¹⁶⁸ Staff Final Schedule PMC-1.

27 ¹⁶⁹ RUCO Final Schedule TJC-36. RUCO refers to this as the "OCRB Weighted Cost of Capital."

28 ¹⁷⁰ Beta measures the systematic risk of a particular entity's stock relative to the market's beta, which is 1.0. Since the market's beta is 1.0, a security with a beta higher than 1.0 is riskier than the market and a security with a beta lower than 1.0 is less risky than the market. See Direct Testimony of Staff Witness Pedro M. Chaves, (Exh. A-16) at 29.

¹⁷¹ RUCO COC Brief at 8, RUCO COC Reply Brief at 4.

¹⁷² COC Rejoinder Testimony of Company witness Thomas J. Bourassa (Exh. A-21) at 28.

1 revenues from regulated activities, 86 percent of CCWC's parent company American States Water's
 2 revenues and 96 percent of its net income were generated by its principal subsidiary, Golden State
 3 Water Company, which also owns 92 percent of American States Water's assets, but CCWC did not
 4 specify the percentage of those revenues derived from regulated services.¹⁷³ CCWC also argues that
 5 Southwest Water Company's earnings per share were negative for the twelve-month period ended
 6 June 30, 2008, and that RUCO's use of this financially troubled company in its proxy group
 7 depressed RUCO's cost of equity estimate by 60 basis points.¹⁷⁴ CCWC contends that *Sun City*
 8 *Water Co. v. Arizona Corp. Comm'n*¹⁷⁵ supports its position that Southwest Water should be
 9 excluded from RUCO's proxy group because it is "financially sick."¹⁷⁶ We disagree. The facts in the
 10 *Sun City* case are distinguishable from this case in two significant ways. First, the court in the *Sun*
 11 *City* case did not address the use of companies in a proxy group for either a DCF or CAPM analysis,
 12 and was instead criticizing the use of comparative earnings analysis for setting a rate of return for the
 13 water utility in question.¹⁷⁷ A comparative earnings analysis, which is not proposed by any party to
 14 this case, differs greatly from the DCF and CAPM analyses in the use of companies for comparison
 15 purposes. Second, the *Sun City* court referred not to an individual "financially sick" company, but to
 16 the "financially sick" condition of the water utility industry as a whole at that time, while criticizing
 17 the comparative earnings analysis used in that case as being particularly inappropriate "when
 18 evidence was presented that this industry was generally sick financially".¹⁷⁸

19 The Company also disagrees with RUCO's use of a sample group of natural gas distribution
 20 utilities, and argues that an adjustment must be made to account for their use as proxies. RUCO
 21 states that gas utilities serve as an appropriate proxy for CCWC because gas and water companies
 22 have similar operating characteristics in terms of distribution and similar risks.¹⁷⁹ CCWC asserts that
 23 because RUCO's water utility proxy group, with an average beta of 0.82, has more systematic
 24

25 ¹⁷³ Company COC Reply Brief at 18-19.

26 ¹⁷⁴ *Id.* at 35, citing Rigsby Dt., Sched. WAR-2.

27 ¹⁷⁵ *Sun City Water Company v. Arizona Corp. Comm'n*, 26 Ariz. App. 304, 310, 547 P.2d 1104, 1110 (App. 1976), *rev'd*
 28 *on other grounds*, 113 Ariz. 464, 556 P.2d 1126 (1976).

¹⁷⁶ Company COC Reply Brief at 19.

¹⁷⁷ *Sun City Water Company*, 26 Ariz. App. at 310, 547 P.2d at 1110.

¹⁷⁸ *Id.*

¹⁷⁹ RUCO COC Brief at 7.

1 (market) risk than its gas utility proxy group, with an average beta of 1.05, that the gas proxy group is
 2 not comparable to CCWC.¹⁸⁰ CCWC argues that because the gas proxy group's average beta is
 3 higher than the water proxy group's, an adjustment must be made to account for the current
 4 difference in risk between a typical water utility and a typical gas utility.¹⁸¹ CCWC asserts that
 5 Commission Decision No. 66849 "rejected the use of gas companies as proxies for a water utility
 6 based on the difference between the average beta of the water utility sample group and average beta
 7 of the gas utility sample group," that "use of the gas utility sample as a proxy for the water utility
 8 would have increased the cost of equity,"¹⁸² and that Staff's position in the case leading to Decision
 9 No. 66849 supports a 250 basis point upward adjustment in this case.¹⁸³ Decision No. 66849 does
 10 not support such an adjustment. Contrary to the Company's assertion, Decision No. 66849 did not
 11 reject Staff's use of a gas proxy group. However, it did reject Staff's position that its use of gas
 12 proxies necessitated a downward adjustment to Staff's cost of equity estimate. Decision No. 66849
 13 instead adopted Staff's unadjusted average of its DCF and CAPM models. The use of a gas utility
 14 sample had the effect of increasing the cost of equity over Staff's recommendation in that case.¹⁸⁴
 15 The Company's argument that a failure in this case to make an upward adjustment would constitute
 16 an arbitrary and capricious action¹⁸⁵ is simply wrong. In this case, as RUCO points out, CCWC itself
 17 used water utilities with the same range of beta as RUCO's gas proxy; one third of the companies in
 18 CCWC's water proxy group have the same range of betas as the companies in RUCO's gas proxy
 19 group; nine of the ten gas utilities in RUCO's gas proxy have betas between 0.80 and 0.90; the
 20 Company's proxy group of six water companies included Connecticut and Middlesex Water
 21 Companies, which have betas ranging between 0.80 and 0.90;¹⁸⁶ and testimony on the record
 22 indicates that there is movement toward using gas utility proxies to derive cost of capital for water

23
 24 ¹⁸⁰ Company COC Brief at 36.

25 ¹⁸¹ *Id.*

26 ¹⁸² Company COC Reply Brief at 19-20, citing Decision No. 66849 (March 19, 2004) *In the Matter of the Application of Arizona Water Company, an Arizona Corporation, for Adjustments to its Rates and Charges for Utility Service Furnished by its Eastern Group and for Certain Related Approvals* at 21.

27 ¹⁸³ Company COC Reply Brief at 20.

28 ¹⁸⁴ Decision No. 66849 at 23.

¹⁸⁵ See Company COC Reply Brief at 20.

¹⁸⁶ RUCO COC Brief at 6-7.

1 companies.¹⁸⁷ The record does not reflect a need for a special adjustment due to RUCO's use of
 2 natural gas distribution utilities as proxies.

3
 4 While the Company arrived at its CAPM cost of equity estimate of 14.6 percent by averaging
 5 its historical market risk premium result of 9.8 percent with its 19.4 percent current market risk
 6 premium result, RUCO did not use a current market risk premium, but reached its CAPM estimate
 7 based on a historic market risk premium.¹⁸⁸ RUCO calculated a range for its CAPM cost of equity
 8 between 8.10 and 9.78 percent for its water sample, and between 6.94 and 8.25 percent for its gas
 9 sample.¹⁸⁹ RUCO contends that because reliance on past performance is a better indicator of future
 10 performance than reliance on analyst's projections of market return and treasury yields, RUCO's use
 11 of a historic market risk premium to derive a CAPM cost of equity capital is appropriate, particularly
 12 in the current economic circumstances.¹⁹⁰ While the Company argues that market volatility does not
 13 make the CAPM unstable or subject to manipulation,¹⁹¹ RUCO concurs with Staff's witness David
 14 Parcell that the current risk premium CAPM is not a proper model in a very depressed market, and
 15 that the Company's CAPM analysis should be rejected because it is based, in part, on a current
 16 market risk premium.¹⁹² RUCO agrees with Mr. Parcell that development of a growth rate from
 17 stocks priced in an extremely depressed market leads to a CAPM which is too high.¹⁹³ RUCO further
 18 argues that the Company's use of a 19.4 percent current market risk premium to determine a cost of
 19 equity capital is inconsistent with the most recently available market data, comparing it to Value
 20 Line's October 24, 2008 projections of 7.50 percent for the return on common equity for the water
 21 industry through the five year period through 2013, for a difference of 1,190 basis points.¹⁹⁴ We
 22 agree with RUCO and Staff that the Company's CAPM should be rejected because it is based, in part
 23 on a current market risk premium, which is inappropriate in a depressed market.

24
 25 ¹⁸⁷ *Id.* at 7, citing Tr. at 776-77.

26 ¹⁸⁸ RUCO COC Brief at 2.

27 ¹⁸⁹ COC Direct Testimony of RUCO witness William A. Rigsby (Exh. R-14) at 333-34.

28 ¹⁹⁰ RUCO COC Brief at 3, RUCO COC Reply Brief at 8.

¹⁹¹ Company COC Reply Brief at 15.

¹⁹² RUCO COC Brief at 4, citing David Parcell's testimony, Tr. at 746, 759-761.

¹⁹³ RUCO COC Reply Br at 7-8, citing Staff witness David Parcell's testimony, Tr. at 759.

¹⁹⁴ RUCO COC Reply Brief at 8, citing Company witness Thomas Bourassa's testimony, Tr. at 580.

1 The Company asserts that RUCO significantly reduced its CAPM cost of equity estimate by
 2 using a geometric mean to calculate the market risk premium, by using two different Treasury
 3 securities as its proxy for the risk-free rate of return, and by using the average total return, instead of
 4 the average income return, on risk-free Treasuries.¹⁹⁵ RUCO derived its historic market premium
 5 using both a geometric and an arithmetic mean of the historical returns on the Standard and Poor's
 6 500 ("S&P 500") index from 1926 to 2007 as the proxy for the market rate of return.¹⁹⁶ RUCO states
 7 that the use of geometric mean is the industry standard, that geometric means are published in
 8 Morningstar, and that Value Line calculates both historic and prospective growth rates on a geometric
 9 or compound growth rate basis.¹⁹⁷ RUCO also argues that its historic market risk premium range of
 10 between 4.90 percent and 6.5 percent, for an average of 5.7 percent, falls close to the range of 4.0 to
 11 5.0 percent identified as reasonable in a recent professional presentation,¹⁹⁸ and the range of 4.5 to
 12 5.5 percent identified as reasonable in a recent publication cited in this case by both the Company and
 13 RUCO.¹⁹⁹ RUCO contends that because its historic market risk premium falls close to the range
 14 identified as reasonable by recent empirical research, and the Company's historic market risk
 15 premium using an arithmetic mean of 7.5 percent does not, the Company's cost of equity
 16 recommendation should be rejected.²⁰⁰ CCWC argues, unconvincingly, that RUCO's use of an
 17 excerpt from the Koller, Goedhart, and Wessels text²⁰¹ (to which the Company cited as supporting a
 18 separate issue) fails to support RUCO's contention that its market risk premium of 5.7 percent, the
 19 average of its geometric and arithmetic mean, is reasonable, because the risk premium in this case is
 20 not being computed with short-term bonds, and because the Company's calculations are not found in
 21 a textbook.²⁰² The Company argues that its 7.5 percent historic market risk premium is not too high,

22
 23 ¹⁹⁵ Company COC Brief at 40-49.

¹⁹⁶ RUCO COC Brief at 4.

24 ¹⁹⁷ *Id.* at 4-5.

25 ¹⁹⁸ *Id.* at 5, citing opinions given by Dr. Aswarth Damdaran, New York University professor of finance and Dr. Felicia C. Marston, University of Virginia professor of finance during a panel discussion presentation at the 39th Annual Financial Forum of the Society of Utility and Regulatory Financial Analysts held April 19 and 20, 2007, at Georgetown University.

26 ¹⁹⁹ RUCO COC Brief at 5, citing *Valuation: Measuring and Managing the Value of Companies*, 4th Ed., 2005, by McKinsey & Company, Inc., Koller, Goedhart, and Wessels, p. 306.

27 ²⁰⁰ RUCO COC Brief at 5.

²⁰¹ *Valuation: Measuring and Managing the Value of Companies*, 4th Ed., 2005, by McKinsey & Company, Inc., Koller, Goedhart, and Wessels, p. 306.

28 ²⁰² Company COC Reply Brief at 17.

1 as RUCO contends, because both Staff and the Company used the arithmetic mean published in the
2 *2008 Ibbotson SBBI Valuation Edition Yearbook* (Morningstar 2008), which calculates the historic
3 risk premium by averaging the historic arithmetic differences between the S&P 500 and intermediate-
4 term government bond income returns for the period 1926 through 2007, and RUCO “has presented
5 no evidence that *Ibbotson’s* calculations are erroneous.²⁰³ Staff’s witness Mr. Parcell states that
6 because investors use both arithmetic and geometric average returns, both should be considered in the
7 development of a risk premium.²⁰⁴ Mr. Parcell states that exclusive use of arithmetic averages leads
8 to a higher, and potentially excessive risk premium, and thus CAPM results, because arithmetic
9 averages exceed geometric averages.²⁰⁵ Although Staff has traditionally used arithmetic averages as
10 a component of its historic risk premium, Staff’s witness Mr. Parcell’s testimony supports RUCO’s
11 use of both arithmetic and geometric averages in the development of the historic market risk
12 premium.

13
14 In response to CCWC’s assertion that RUCO significantly reduced its CAPM cost of equity
15 estimate by using two different Treasury securities as its proxy for the risk-free rate of return, and by
16 using the average total return, instead of the average income return, on risk-free Treasuries, RUCO
17 states that initially, it used both intermediate and long-term securities to estimate the risk-free rate of
18 return, but then recalculated its historic market risk premium, using matching intermediate treasuries
19 as advocated by the Company, and that the impact of recalculating its cost of equity capital estimate
20 based on the Company’s methodology would be an increase of 10 basis points, from 6.38 percent to
21 6.48 percent.²⁰⁶ RUCO explains that it is not modifying its recommendation, because its
22 recommendation of 6.38 percent is based on a market risk premium that already exceeds the market
23 risk premium recommended by the authorities on which RUCO relied.²⁰⁷

24 CCWC asserts that RUCO’s reliance on only the sustainable growth method to estimate the
25 dividend growth component of its constant growth DCF estimate also causes RUCO’s cost of equity

26 ²⁰³ *Id.*

27 ²⁰⁴ Surrebuttal Testimony of Staff witness David C. Parcell (Exh. S-7) at 10.

28 ²⁰⁵ *Id.*

²⁰⁶ RUCO COC Reply Brief at 6.

²⁰⁷ *Id.* at 7.

1 estimate to be understated.²⁰⁸ CCWC argues that RUCO failed to disclose the key inputs necessary to
 2 estimate the internal or retention growth rate it used in the constant growth DCF model, and the
 3 estimate should be rejected because it cannot be reproduced or updated based on more current market
 4 data or information.²⁰⁹ RUCO responds that this argument is a red herring, as there was essentially
 5 no difference between the parties' cost of capital experts' estimates of average sustainable growth for
 6 water utility proxies.²¹⁰ RUCO points out that CCWC's cost of capital expert estimated the average
 7 sustainable growth to be 6.39 percent for his water utility sample, leaving a difference of only 9 basis
 8 points between the Company's estimate and RUCO's estimate, which was 6.30 percent.²¹¹

9
 10 CCWC argues that because Mr. Parcell testified that he was required to accept the models and
 11 inputs used by Staff's witness, Mr. Chaves, to estimate CCWC's cost of equity, Mr. Parcell's
 12 testimony has limited relevance to this case.²¹² Until it filed its reply brief, the Company's arguments
 13 actually ignored Staff's recommended cost of equity of 10.1 percent, apparently preferring to argue
 14 that "Staff's final recommendation is 11.9 percent," and that Staff's recommendation is "not affected
 15 by recent market volatility and related events."²¹³ The Company also argued that the only aspect of
 16 Mr. Chaves' methods Mr. Parcell actually disagreed with was that Staff's current market risk
 17 premium estimate was too high due to current market volatility.²¹⁴ Because Staff filed surrebuttal
 18 testimony withdrawing its recommendation for a Hamada adjustment prior to the hearing,²¹⁵ The
 19 Company's post-hearing brief argument against the "recommended 180 basis point downward
 20 adjustment to [Staff's] 11.9 percent cost of equity estimate"²¹⁶ is misplaced and irrelevant.

21 Staff is critical of the Company's use, in the current economic environment, of spot stock
 22 prices in its DCF and CAPM models.²¹⁷ Staff argues that these are not normal times, and that times

24 ²⁰⁸ Company COC Brief at 38.

25 ²⁰⁹ *Id.* at 38-39

26 ²¹⁰ RUCO COC Reply Brief at 2.

27 ²¹¹ *Id.*

28 ²¹² Company COC Brief at 49.

²¹³ *Id.* at 50-51(emphasis in original).

²¹⁴ *Id.* at 50.

²¹⁵ Surrebuttal Testimony of Staff witness David C. Parcell (Exh. S-7) at 12.

²¹⁶ Company COC Brief at 52-55.

²¹⁷ Staff COC Brief at 6.

1 such as these may require a departure from methods the Commission has previously relied on.²¹⁸
 2 Staff's witness testified that market models such as the DCF and CAPM are forward looking, and
 3 assume that stock prices and interest rates reflect current expectations of the future, but that such
 4 assumptions are not applicable in today's economic environment.²¹⁹

5
 6 The Company asserts that the riskiness of the sample water utilities the parties used to
 7 estimate cost of equity has increased since CCWC's last rate case, as shown by the sample
 8 companies' increase in their average beta, which the Company states is currently 0.93, while the
 9 average beta for the same proxy group was 0.68.²²⁰ The Company argues that the fact that the
 10 markets are riskier now than in previous years requires a higher cost of equity than CCWC was
 11 authorized in its prior case, in order to allow it to continue to attract capital.²²¹ Staff notes that its
 12 cost of equity recommendation of 10.1 percent constitutes an 80 basis point increase from the 9.3
 13 percent cost of equity as determined in Decision No. 68176 and upheld by the Court of Appeals, but
 14 that the Company's cost of equity estimate of 11.5 percent constitutes an increase of 220 basis points.
 15 ²²² Staff contends that the Company has failed to justify such a large increase in its cost of equity.²²³

16 We certainly recognize that current market conditions present increased risks over recent
 17 years for many companies. However, we do not find that a general increased level of risk justifies
 18 the cost of equity requested by the Company. While the Company is critical of the inputs RUCO and
 19 Staff chose to use in their cost of equity estimation models, as discussed herein, several of the
 20 Company's arguments against them are unsupported by the facts. Taken in total, we find the
 21 methodologies Staff and RUCO used to be less biased than those used by the Company, and more
 22 reasonable and more reflective of current market conditions. Based on the analyses presented, we
 23 find a cost of common equity of 9.9 percent to be reasonable in this case.

24
 25
 26 ²¹⁸ *Id.*

²¹⁹ Tr. at 740.

²²⁰ Company COC Brief at 1.

²²¹ Company COC Reply Brief at 10-11.

²²² Staff COC Reply Brief at 3

²²³ *Id.*

1 **C. Cost of Capital Summary**

	Percentage	Cost	Weighted Cost
2 Debt	24.0	5.0%	1.20%
3 Common Equity	76.0	9.9%	<u>7.52%</u>
4 <u>Weighted Average</u> 5 <u>Cost of Capital</u>			<u>8.72%</u>

6 **D. Fair Value Rate of Return**

7
8 CCWC's most recent rate proceeding, which resulted in Decision No. 68176, was the subject
9 of an Arizona Court of Appeals decision which ordered a remand to this Commission on the issue of
10 the method used to calculate operating income. Decision No. 68176 determined operating income
11 and set rates in a manner consistent with prior Commission decisions, by multiplying the weighted
12 average cost of capital ("WACC") by the OCRB, and dividing the resulting product by the FVRB²²⁴
13 in order to determine a FVROR. Under that method, the operating income, determined by
14 multiplying the FVRB times the FVROR, provided the same operating income as multiplying the
15 WACC by the OCRB.

16 Following the Remand Proceeding ordered by the Arizona Court of Appeals, a hearing was
17 held and Decision No. 70441 (July 28, 2008) was issued. Decision No. 70441 did not adopt the
18 Company's proposal to determine a FVROR by applying the WACC directly to the FVRB, but
19 revised the method used in Decision No. 68176 to calculate operating income. The Commission
20 found that applying the WACC to the FVRB would over-compensate the Company for inflation and
21 calculated the FVROR by adjusting the WACC to reflect an inflation adjustment that reduced the cost
22 of equity.²²⁵ The FVROR was then applied to the FVRB to determine operating income. Decision
23 No. 70441 found that the evidence presented in the Remand Proceeding was not sufficiently
24 developed to make a determination of whether the cost of debt reflects the effects of inflation, and
25 therefore Decision No. 70441 did not adopt an inflation adjustment to the cost of debt.

26
27
28 ²²⁴ In Decision No. 70441 and in this case, the FVRB reflects a 50/50 weighting of OCRB and RCND.

²²⁵ Decision No. 70441 at 41.

1 The Company has appealed Decision No. 70441, and in this proceeding, continues to
 2 advocate applying the WACC directly to its FVRB, without any inflation adjustment, in order to
 3 calculate the Company's authorized operating income.²²⁶ RUCO advocates using the same
 4 methodology in this case as that used in Decision No. 70441 to reach a FVROR, by deducting a
 5 general inflation component from the cost of equity in order to avoid double-counting inflation
 6 ("Method 1").²²⁷ Staff's FVROR proposal in this case is based on the FVROR formula used in
 7 Decision No. 70441, but with a change to the application of the inflation adjustment. Staff's
 8 methodology removes the inflation component from both the cost of equity and the cost of debt to
 9 determine a FVROR ("Method 2"). Staff states that Method 1 remains a viable alternative for
 10 computing the FVROR,²²⁸ but that Method 2 benefits a utility by providing higher returns when
 11 utility property appreciates at a rate exceeding the additional return required by investors due to
 12 inflation.²²⁹

13 The Company argues that application of the unadjusted WACC to FVRB is necessary to
 14 allow the utility to earn a fair return on the current value of its property.²³⁰ CCWC charges that the
 15 recommendations of Staff and RUCO are predicated on the view that the rate of return must be
 16 reduced if the fair value of the utility's plant is used as its rate base, and that their FVROR
 17 approaches are "intended to deprive Chaparral City of the benefit of the increase in value of its
 18 property."²³¹ CCWC continues to argue that the WACC can be directly applied to FVRB because the
 19 WACC is a function of the ratio of debt in its capital structure, and does not depend on either the
 20 amount of invested capital or the size of the rate base used to set rates, and that a market-derived rate
 21 of return can appropriately be applied to a market-based rate base.²³² The Company also argues that
 22 application of the unadjusted WACC to FVRB is appropriate because the rate of return is not related
 23

24 ²²⁶ Company COC Brief at 27. The Company continues to argue issues previously decided in Decision No. 70441, and
 25 some of those issues are discussed herein. The fact that this Decision does not again address some of the arguments re-
 26 proffered by the Company in this case, such as, for example, its arguments regarding market-based rate base and market-
 27 derived return, does not change our analysis and determination thereon as set forth in Decision No. 70441.

28 ²²⁷ RUCO COC Brief at 10, RUCO COC Reply Brief at 10.

²²⁸ Staff COC Brief at 5.

²²⁹ *Id.*

²³⁰ Company COC Brief at 14.

²³¹ Company COC Brief at 26, 27.

²³² *Id.* at 20, 22-23.

1 to rate base, and because the inputs used to develop the WACC have no relationship to the type of
 2 rate base to which the WACC is applied.²³³ CCWC argues that FVRB is not the “inflated” cost of its
 3 plant, but is the average of its OCRB and RCND,²³⁴ and contends that the downward adjustment to
 4 the WACC as recommended by RUCO and Staff to determine a FVROR “undermines the use of fair
 5 value.”²³⁵

6 We agree with the Company that there has been no dispute in this case that FVRB is the
 7 average of CCWC’s OCRB and RCND. We disagree with the Company, however, that the FVROR
 8 methodologies proposed by RUCO and Staff “undermine” the use of fair value, or “deprive Chaparral
 9 City of the benefit of the increase in value of its property.” There are many methods the Commission
 10 can use to determine an appropriate FVROR, and as we found in Decision No. 70441, one of those
 11 methods is adjusting the WACC to exclude the effect of inflation. RUCO and Staff’s
 12 recommendations both adjust the WACC to exclude the effect of inflation in order to calculate a
 13 FVROR for the Company. CCWC claims that Staff and RUCO have focused on the effect of
 14 inflation on the cost of capital, but have ignored its effect on rate base, that neither provided a study
 15 or analysis of the impact of inflation on the Company’s rate base.²³⁶ CCWC contends that utilizing
 16 an inflation adjustment to reach a FVROR incorrectly assumes that general inflation in the economy
 17 affects both rate base and the cost of capital in the same way.²³⁷ We disagree. The FVROR analyses
 18 provided by RUCO and Staff focused on the inflation component contained in cost of capital. The
 19 effect of inflation on rate base is separately calculated in determining the RCND, and the Company’s
 20 proposed method has been accepted by the Commission.
 21

22 As we determined after considering all the evidence in the Remand Proceeding in Docket No.
 23 W-02113A-04-0616, the FVRB, which was the average of OCRB and RCND, included an inflation
 24 component.²³⁸ The FVRB in this case was determined in the same way as the FVRB we considered
 25

26 ²³³ *Id.* at 16, 21.

27 ²³⁴ *Id.* at 3.

28 ²³⁵ *Id.* at 57.

²³⁶ *Id.* at 60-64.

²³⁷ *Id.*

²³⁸ Decision No. 70441 at 41, Findings of Fact No. 14.

1 in Decision No. 68176 and Decision No. 70441. The record in this proceeding contains essentially
 2 the same arguments CCWC made in the Remand Proceeding and affords no basis upon which to
 3 reverse our determination of fact on the issue. The Company acknowledges that the RCND is the
 4 current value of its plant based on its reconstruction cost, and there is no dispute in this case that
 5 FVRB is the average of OCRB and RCND. RUCO and Staff's FVROR recommendations in this
 6 case both take into consideration our determination in Decision No. 70441 that the FVRB, which is
 7 the average of OCRB and RCND, includes an inflation component. The Company provided no study
 8 or other evidence that controverts the existence of an inflation component in RCND rate base. We
 9 note that the Company used the Handy-Whitman Index and the Consumer Price Index to trend its
 10 OCRB to a RCND value.²³⁹ Both of these indices are measures of inflation. Clearly, the RCND
 11 value proposed by the Company includes inflation, and that inflation component carries into the
 12 FVRB.

13
 14 The Company's proposal in this case to determine a rate of return by applying the WACC
 15 directly to a FVRB comprised of an average of OCRB and RCND does not include an adjustment to
 16 account for inflation. CCWC contends that the fact that application of the WACC to FVRB may
 17 produce return dollars greater or less than would be produced using the "prudent investment"
 18 approach is irrelevant, because fair value ratemaking is intended to recognize increases (and
 19 decreases) in property values.²⁴⁰ The Company continues its argument from the Remand Proceeding
 20 that *Duke Power*²⁴¹ supports its position on FVROR,²⁴² because the *Duke Power* court determined
 21 that North Carolina's ratemaking statutes required the North Carolina Utilities Commission to treat
 22 the difference between the OCRB and the FVRB as equity.²⁴³ Staff points out that in North Carolina,
 23 the state's police power regarding ratemaking resides with the legislature, in contrast to Arizona,
 24 where the Arizona Constitution places Arizona's ratemaking authority exclusively with this
 25 Commission, and that *Duke Power* involved interpretation of a statute governing the treatment of

26 ²³⁹ Direct Testimony of Thomas J. Bourassa (Exh. A-3) at 7-8; Decision No. 70441 at 31-32.

27 ²⁴⁰ Company COC Brief at 14.

28 ²⁴¹ *State ex rel. Utilities Comm'n v. Duke Power Company*, 206 S.E.2d 269 (N.C. 1974).

²⁴² Company COC Brief at 25-26.

²⁴³ *State ex rel. Utilities Comm'n v. Duke Power Company*, 206 S.E.2d 269 (N.C. 1974).

1 FVRB.²⁴⁴ As noted in Decision No. 70441, the Company's reliance on *Duke Power* is misplaced,
 2 because the North Carolina Supreme Court indicated that the North Carolina Commission could
 3 consider the effect of inflation in computing the cost of capital, and remanded that case to the North
 4 Carolina Commission because the fair rate of return determination had been made "through a
 5 misunderstanding" of another decision by the North Carolina Supreme Court.²⁴⁵ The Company also
 6 continues to argue in this case that the Illinois case *City of Alton*²⁴⁶ supports its position.²⁴⁷ As
 7 Decision No. 70441 states, the methods addressed in that case are not helpful in setting rates in
 8 Arizona, as they seem to be after the fact, "fall-out numbers" determinations.²⁴⁸ CCWC has not
 9 presented any legal arguments that convince us to change our determination made in Decision No.
 10 70441.

11 Staff and RUCO are in agreement that, as Decision No. 68176 and Decision No. 70441 have
 12 already found, the Company's proposal to adopt the WACC as the FVROR and apply it to the FVRB
 13 would produce excessive returns.²⁴⁹ RUCO takes issue with the Company's assertion²⁵⁰ that the
 14 WACC is the fair rate of return regardless of the rate base to which it is applied.²⁵¹ RUCO argues
 15 that an appropriate rate of return is one that compensates, but does not overcompensate, the Company
 16 for its costs.²⁵² RUCO states that Decision No. 70441 determined that the double counting of
 17 inflation in rate base and the rate of return would unfairly overcompensate investors,²⁵³ and Staff
 18 contends that rates producing an excessive return would be neither just nor reasonable.²⁵⁴ In response
 19 to the Company's assertion that the results of the Remand Proceeding are "anomalous,"²⁵⁵ Staff
 20 responds that this Commission, in the Remand Proceeding resulting in Decision No. 70441, was
 21

22
 23 ²⁴⁴ Staff COC Reply Brief at 5-6.

²⁴⁵ Decision No. 70441 at 24-25.

24 ²⁴⁶ *City of Alton v. Commerce Comm'n*, 165 N.E.2d 513 (Ill. 1960).

²⁴⁷ Company COC Brief at 23-26.

25 ²⁴⁸ Staff COC Reply Brief at 6, citing Decision No. 70441 at 25-26.

²⁴⁹ Staff COC Reply Brief at 4, RUCO COC Reply Brief at 10.

26 ²⁵⁰ Company COC Brief at 20-24.

²⁵¹ RUCO COC Reply Brief at 9.

²⁵² *Id.*

27 ²⁵³ RUCO COC Brief at 10, RUCO COC Reply Brief at 10.

²⁵⁴ Staff COC Reply Brief at 4.

28 ²⁵⁵ Company COC Brief at 6.

1 completely within its constitutional authority to craft a FVROR methodology that removed the effects
2 of inflation.²⁵⁶

3
4 The Company's extensive arguments on brief in this case repeat the arguments made in the
5 Remand Proceeding, and provide no basis for a deviation from our finding in those Decisions that
6 applying WACC to the FVRB would inappropriately allow inflation to be reflected in both the
7 WACC and in the FVRB, thus overstating inflation.²⁵⁷ The Company is correct that fair value
8 ratemaking recognizes increases or decreases in property values, which in this case is accomplished
9 through the use of a FVRB that includes an RCND component. In addition, fair value ratemaking
10 also recognizes the need for a fair return on the fair value of utility property. The Company's
11 proposal must be rejected, because a rate of return reached by applying the WACC directly to its
12 FVRB which includes inflation would overcompensate for inflation, and would produce an excessive
13 return on FVRB, thereby resulting in rates and charges that would be excessive, and therefore not just
14 and reasonable.

15 In order to calculate the inflation factor in the WACC, both Staff and RUCO's methods
16 subtracted the yields on Treasury inflation protected securities ("TIPS") from the yields on Treasury
17 securities with constant maturities. Staff used the 2.4 percent difference between the spot yields on a
18 20-year Treasury and a 20-year TIPS as a proxy for expected inflation.²⁵⁸ Because one half of the
19 FVRB includes OCRB, which does not include inflation, Staff adjusted the 2.4 percent inflation
20

21 ²⁵⁶ Staff COC Reply Brief at 4.

22 ²⁵⁷ See Decision No. 70441 at 36.

23 ²⁵⁸ Staff calculated its inflation adjustment as follows:

24	20-year Treasury Yield (as of 8/6/08)	4.7%
25	less: 20-year Treasury Real Yield (as of 8/6/08)	<u>2.3%</u>
26	Return required by investors due to inflation*	2.4%
27	Times a 50% factor (to account for lack of inflation in OCRB)	0.5
28	Inflation adjustment	1.2%

* Staff's Final Schedule PMC-2 showed 2.5%, presumably due to rounding, which is corrected here to 2.4%.

Staff Final Schedule PMC-2; Direct Testimony of Staff witness Pedro M. Chaves adopted by Staff witness David C. Parcell (Exh. S-8) at 36-37; Direct Testimony of Staff witness Gordon L. Fox (Exh. S-5) at 4-11.

1 factor by one-half, resulting in an inflation adjustment to the WACC of 1.2 percent.²⁵⁹ RUCO used
2 historic average Treasury yields for the period 2001 through the first half of 2008 to reach its
3 inflation estimate and deducted 200 basis points from its unadjusted cost of equity to derive the return
4 that RUCO recommends be applied to the Company's FVRB.²⁶⁰

5 The Company disagrees with RUCO's 200 basis point inflation adjustment.²⁶¹ CCWC argues
6 that any inflation adjustment should be reduced by one-half to account for the fact that one-half of the
7 FVRB is comprised of plant valued at its historic cost, and that if an inflation adjustment is found
8 appropriate in this case, the adjustment should not exceed 100 basis points.²⁶² The Company
9 contends that Staff's methodology is more appropriate than RUCO's, arguing that because RUCO's
10 inflation adjustment is based on historical information, it is not a good proxy for any future inflation
11 contained in investors' expected equity returns.²⁶³ While the Company finds Staff's methodology
12 preferable, it disagrees with Staff's inputs, and argues that Staff should have used 5-year Treasuries
13 instead of 20-year Treasuries, and that Staff failed to update its estimate to take into account current
14 inflationary expectations.²⁶⁴ At the hearing on January 9, 2009, Staff's witness Mr. Parcell testified
15 that during the current economic climate, economists' opinions of projected inflation would be a
16 much better indicator of expected inflation, and stated that in recent testimony, he had found that the
17 consensus forecast for inflation was 2 to 2.5 percent.²⁶⁵ Mr. Parcell's testimony corroborates and
18 validates Staff's earlier 2.4 percent estimate, obtained using the Treasury yields as of August 6, 2008.
19

20 CCWC disagrees with Staff's Method 2 for calculating the FVROR. CCWC argues that it is
21 improper to apply an inflation adjustment to both the debt and equity portions of the Company's
22 capital structure, and that Method 2 erroneously treats the cost of its long-term debt as if it increases

23 _____
²⁵⁹ *Id.*

24 ²⁶⁰ RUCO Final Schedule TJC-36; Direct Testimony of RUCO witness William A. Rigsby (Exh. R-14) at 62.

25 ²⁶¹ Company COC Reply Brief at 24.

26 ²⁶² *Id.*

27 ²⁶³ Company COC Brief at 62.

28 ²⁶⁴ *Id.*

²⁶⁵ Tr. at 748-749. Mr. Parcell's testimony was in response to a Federal Reserve Statistical Release ("FRSR") dated January 7, 2009, which the Company introduced at the hearing (Exh. A-17). Mr. Parcell testified that in normal times, looking at the differential between long-term Treasury bonds and long-term interest rate swaps using the same maturity may be a reasonable way to develop a proxy for inflation, but that in the current economic environment using the differential is problematic because both instruments have been driven to such low levels.

1 or decreases based on current market conditions.²⁶⁶ CCWC argues that because its cost of debt is
 2 determined based not on current market debt costs, but on its pre-existing, embedded cost of debt,
 3 which does not increase or decrease in response to future inflation or other economic conditions,
 4 Method 2 should be rejected.²⁶⁷ CCWC is correct that its cost of debt is determined based not on
 5 current market debt costs, but on its pre-existing, embedded cost of debt, which does not increase or
 6 decrease in response to future inflation or other economic conditions. However, as CCWC itself
 7 acknowledges, inflation is a component of the cost of debt. The Company states in a footnote that
 8 “[i]n some cases, there may be a secondary market for bonds, notes and other debt instruments. The
 9 price that a purchaser is willing to pay for a particular debt instrument is affected by a number of
 10 different factors, including expected inflation.”²⁶⁸ The Company’s footnote goes on to state that
 11 despite the existence of secondary markets, “the borrower’s obligation to pay interest in accordance
 12 with the terms of the debt instrument is unaffected by such secondary sales and remains fixed.”²⁶⁹
 13 While this is true, it does not change the fact that debt includes an inflation component. The cost of
 14 debt includes the investors’ expectations regarding inflation, and, as Staff explains, a change in
 15 purchase price of debt instruments on the secondary market reflects the change in debt cost that the
 16 investor requires due to inflation.²⁷⁰ While the Company is correct that the inflation component
 17 embedded in its existing debt does not change unless it is refinanced, the inflation component is
 18 nonetheless there, and the Company failed to provide an estimate of that inflation component
 19 embedded its existing debt. Accordingly, the best evidence available on the record is Staff’s. Staff’s
 20 proposed Method 2 applies the inflationary adjustment to the entire cost of capital, including equity
 21 and debt, in recognition of the fact, demonstrated in the record in this case,²⁷¹ that inflation is a
 22 component of debt as well as equity.

23
 24 The Company contends that RUCO’s proposed rate of return of 6.38 percent is too low and
 25 attempts to support its position by comparing it to the 9 percent interest rate on investment grade

26 ²⁶⁶ Company COC Brief at 67, 69.

27 ²⁶⁷ *Id.*

28 ²⁶⁸ Company COC Brief at 68, fn 279.

²⁶⁹ *Id.*

²⁷⁰ Staff COC Reply Brief at 8.

²⁷¹ *See, e.g.,* Direct Testimony of Staff witness Gordon L. Fox (Exh. S-5) at 5-7.

1 (Baa) bonds.²⁷² RUCO argues in response that the Company's reliance on a FRSR showing the
2 interest rate on investment grade bonds at 9 percent is misplaced because the FRSR does not
3 distinguish the rates of return for utilities bonds from other corporate bonds.²⁷³ RUCO believes that
4 the Company's rate of return comparison should be based on the returns of regulated utilities as
5 opposed to the returns of other corporations, and recommends that the Commission consider, instead
6 of the January 7, 2009, FRSR,²⁷⁴ the January 9, 2009 Value Line Investment Survey,²⁷⁵ which
7 contains statistical analysis of corporate bond yields, but distinguishes yields on utility bonds from
8 yields on other corporate bonds, and shows the return on corporate utility bonds for 25-30 year grade
9 Baa/BBB to be 6.58 percent.²⁷⁶ Our FVROR determination in this proceeding is not based on any
10 comparable earnings analysis, but on the market-based analyses performed by the parties. However,
11 we note that the Company's argument that a 6.38 percent FVROR is too low because the interest rate
12 on investment grade (Baa) bonds is 9 percent is not convincing, and that RUCO is correct that if such
13 a comparison were to be made, it would be more appropriate to compare the recommended rates of
14 return to yields on utility bonds rather than on the FRSR produced by the Company at the hearing.

15
16 The Company again asserts that if adjustments are made to components of the WACC to
17 account for inflation, inflation must also be considered in relation to operating expenses,²⁷⁷ and
18 contends that the normalization of test year operating expenses using expense levels from 2004 and
19 2005 as recommended by RUCO and Staff ignores inflationary effects.²⁷⁸ The Company argues that
20 considering the impact of inflation only on the cost of capital ignores the impact of inflation on the
21 Company's overall earnings, and argues that adjusting cost of equity estimates to account for
22 inflation in determining the rate of return while ignoring the impact of inflation on the Company's
23 overall cost of providing service amounts to "piecemeal regulation."²⁷⁹ The Company contends that
24 if an inflation adjustment is used to determine its rate of return, an upward adjustment using the same

25 ²⁷² See Exh. A-17, FRSR dated January 7, 2009.

26 ²⁷³ RUCO COC Brief at 10.

27 ²⁷⁴ Exh. A-17.

28 ²⁷⁵ Exh. R-16.

²⁷⁶ RUCO COC Brief at 10.

²⁷⁷ Company COC Brief at 3-4.

²⁷⁸ *Id.*

²⁷⁹ *Id.*

1 percentage should be made to its test year operating expenses, in order to account for the impact of
 2 inflation during 2007 and 2008, and during the time rates will be in effect.²⁸⁰ The “matching”
 3 adjustment to operating expenses proposed by the Company is unsupported by the evidence and
 4 inappropriate. We disagree with the Company’s assertion that adjusting the WACC to arrive at a
 5 FVROR “ignores the impact of inflation on the Company’s overall earnings,” or amounts to
 6 “piecemeal regulation.” As Staff explains, an adjustment to the WACC to arrive at the FVROR is not
 7 an adjustment to reflect matching, but is necessary to avoid double counting of inflation that is found
 8 in the RCND rate base and in the cost of capital.²⁸¹ As we noted in Decision No. 70441, removing
 9 inflation from the return no more amounts to “piecemeal regulation” than does adding inflation to the
 10 rate base.²⁸² In contrast to FVROR, which is forward-looking, operating expenses are matched with
 11 associated revenues.²⁸³ Inflation in operating expenses is already inherently recognized in the
 12 ratemaking framework, which encourages utilities to seek operating efficiencies²⁸⁴ and allows
 13 modifications to test year expenses based on known and measurable changes in costs during the test
 14 year. There is no basis in the record to support the Company’s proposed inflationary adjustment to
 15 operating expenses.

16
 17 The rate of return applied to a utility’s FVRB is designed to (1) allow the utility to attract
 18 capital on reasonable terms; (2) maintain the utility’s financial integrity; and (3) permit the utility to
 19 realize a return that is commensurate with the returns earned by enterprises with commensurate risks.
 20 CCWC states that in setting its rate of return, this Commission must take into account the risks
 21 associated with the particular rate-setting methodologies used in Arizona and their impact on the
 22 Company’s ability to earn a reasonable return on the fair value of its utility plant used to provide
 23 service.²⁸⁵ CCWC contends that a lack of adjustment mechanisms and inability to obtain rate relief
 24 outside a general rate case create additional business risk and requires a “higher return on equity,”²⁸⁶

25 ²⁸⁰ *Id.*

26 ²⁸¹ Staff COC Brief at 4, citing Tr. at 461.

27 ²⁸² Decision No. 70441 at 32.

28 ²⁸³ Tr. at 461.

²⁸⁴ Tr. at 461.

²⁸⁵ *Id.*

²⁸⁶ *Id.* at 19.

1 and that the regulatory lag related to Arizona's use of a historic test year impacts the Company's
2 ability to earn a reasonable return.²⁸⁷ The Company states that operating expenses reflected in its
3 current rates are based on the 12-month period ended December 31, 2003, and that it is not currently
4 earning a return on the increased value of its plant since its rates were set in Decision No. 68176, or
5 on plant constructed and placed in service since December 31, 2003.²⁸⁸ The Company complains that
6 when rates are set in this case, they will be based on operating expenses for the year ended December
7 31, 2006, and will not provide the Company with a return on plant constructed and placed in service
8 after December 31, 2006.²⁸⁹ The Company's argument ignores the fact that in this case, we are
9 allowing \$1.28 million in post-test year plant to be included in rate base. The issues the Company
10 raises here related to the regulatory lag and Arizona's constitutional constraints affecting the
11 ratemaking process are issues that apply to all Arizona utilities, and not just CCWC. As RUCO
12 acknowledges, the fundamental premise of the return on rate base ratemaking approach is to allow
13 utilities an opportunity to recover their actual costs, including their actual cost of capital, consistent
14 with competitive industries.²⁹⁰ Applying the WACC directly to a utility's FVRB when the WACC
15 includes an inflation component would not accomplish this ratemaking goal. As Staff contends, the
16 Company is advocating for a rate of return methodology which would produce comparably higher
17 rates, which conflicts with the most basic tenet of rate regulation, which is that a utility should be
18 provided with rates that will allow it an opportunity to earn a return that is comparable to those of
19 similarly situated enterprises.²⁹¹ We addressed these arguments in Decision No. 70441, and nothing
20 presented in this case causes us to change our determination therein.

21 In determining an appropriate and equitable level for the FVROR in this case, we are mindful
22 of the need for the Company to have the ability to attract capital and obtain a fair return, and we are
23 also mindful of the need to take into account the interests of the ratepayers. As we found in Decision
24 No. 68176 and Decision No. 70441, using the Company's proposed methodology would produce
25

26 ²⁸⁷ *Id.* at 19-20.

27 ²⁸⁸ *Id.* at 65.

28 ²⁸⁹ *Id.*

²⁹⁰ RUCO COC Reply Brief at 9.

²⁹¹ Staff COC Reply Brief at 5, citing *Federal Power Comm'n v. Hope Natural Gas*, 320 U.S. 591, 64 S.Ct. 281 (1944).

1 excessive returns, and it must therefore be rejected. Because there is an inflation component in the
 2 Company's FVRB, all inflation must be removed from the rate of return, whether in debt or equity.
 3 While further refinements to methodologies to accomplish this necessity may be possible, and are
 4 encouraged, we find that Staff's Method 2 appropriately matches an inflation-free rate of return to
 5 FVRB. The Method 2 recommendation of Staff to apply an inflation adjustment to both the equity
 6 and debt components of the WACC is a reasoned and sound approach to determining a FVROR that
 7 equitably balances the needs of the Company and its ratepayers, and results in the setting of just and
 8 reasonable rates. We therefore adopt a FVROR of 7.52 percent in this case.

9 **E. Fair Value Rate of Return Summary**

10	Weighted Average Cost of Capital	8.72%
	Inflation Adjustment	-1.20%
11	Fair Value Rate of Return	7.52%

12 **VII. AUTHORIZED INCREASE**

13 Based on our findings herein, we determine that the Company's gross revenue should increase
 14 by \$1,764,371.

15	Fair Value Rate Base	\$26,776,414
	Adjusted Operating Income	943,185
16	Required Fair Value Rate of Return	7.52%
	Required Operating Income	\$2,013,586
17	Operating Income Deficiency	\$1,070,401
18	Gross Revenue Conversion Factor	1.6483
	Gross Revenue Increase	\$1,764,371

19
 20 **VIII. RATE DESIGN**

21 **A. Irrigation and Construction Rates**

22 The Company is proposing the same rate design approved in Decision No. 68176, with the
 23 exception of increasing the commodity rate for Irrigation and Construction water. Zero gallons are
 24 included in the monthly minimum charge, and the commodity rate has three inverted tier blocks, with
 25 the first breakover point at 3,000 gallons, and the second breakover point at 9,000 gallons. In order
 26 to eliminate the disparity in the current rate design between Irrigation and Construction water
 27 customers and other customers, and to promote water conservation,²⁹² the Company proposes to

28 ²⁹² Company Brief at 25.

1 charge Irrigation and Construction water customers the same monthly minimum charges as other
2 customers according to meter size, with a single Irrigation and Construction commodity rate equal to
3 the first tier commodity charge for commercial and industrial customers, for all usage. Staff proposes
4 a rate design similar to the Company's for Irrigation and Construction water.²⁹³ Currently, the
5 Irrigation Service commodity charge is a flat \$1.56 per 1,000 gallons, which is lower than the first
6 tier commodity rate for 3/4-inch metered residential customers. The Company believes that from a
7 water conservation standpoint, customers using potable water for irrigating turf and landscaping
8 should be charged more.²⁹⁴ Under the rates proposed by the Company, RUCO, and Staff in their
9 final schedules, the commodity charge would increase to \$3.34, \$2.65, and \$2.95, respectively, with
10 the differences being due to differing recommended revenue requirements. Staff states that the
11 purpose of its proposal is to move the rates for Irrigation and Construction water closer to the
12 commodity rates paid by other customers, and that it believes the approach will help in promoting
13 water conservation.²⁹⁵

14 Pacific Life argues that the Company's proposed increase for Irrigation and Construction
15 water customers was not properly noticed.²⁹⁶ Staff states that CCWC published notice in compliance
16 with the rate case procedural order issued in this case, and that Pacific Life filed for intervention on
17 September 15, 2008, which was granted on September 26, 2008. Staff notes that Pacific Life did not
18 raise any issues regarding notice once it was granted intervenor status, or during the time leading up
19 to the date for filing direct testimony.²⁹⁷ As Staff notes, Pacific Life did not file direct testimony or
20 actively participate during the evidentiary hearings.²⁹⁸ The Company points out that, as Pacific Life
21 discusses in its brief, a discussion of the increases in specific rates for specific customer classes was
22 set forth in the Company's filing in the direct testimony of its accounting witness,²⁹⁹ and that the
23 direct testimony of the Company's witness Mr. Hanford also addressed the Company's requested
24 change in the irrigation rate. Those direct testimonies were filed with the Company's application,

25 ²⁹³ Staff Final Schedule MEM-27.

26 ²⁹⁴ Company Brief at 25.

27 ²⁹⁵ Staff Brief at 12-13; Staff Reply Brief at 6.

28 ²⁹⁶ Pacific Life Brief at 1-4.

²⁹⁷ Staff Reply Brief at 9-10.

²⁹⁸ *Id.* at 10.

²⁹⁹ Company Reply Brief at 19.

1 and the published notice directed interested parties how to view a copy of the application. The
 2 notice, which was published on August 6 and August 13, 2008, also specifically stated that “[t]he
 3 actual percentage rate increase for individual customers would vary depending on the type and
 4 quantity of service provided. You may contact Chaparral City to determine what the effect of its rate
 5 proposal may be on your individual bill.” The record in this proceeding reflects the fact that while
 6 Pacific Life may have chosen not to take advantage of its procedural opportunities to present a case
 7 and cross examine witnesses in this proceeding, the opportunity was available to it, and Pacific Life
 8 was not procedurally disadvantaged.

9 Pacific Life argues that the Company’s proposed increase for Irrigation and Construction
 10 water customers could be detrimental to golf course and residential users.³⁰⁰ The Company contends
 11 that this claim by Pacific Life on brief is unsupported by any evidence on record in this case, and that
 12 the two possible explanations for the lack of evidence are (1) the evidence does not exist; or (2)
 13 Pacific Life failed to avail itself of the opportunity to present evidence.³⁰¹ Staff states that it is
 14 concerned about the effect a rate increase will have on all customers, including irrigation customers,
 15 and that in making its recommendations, Staff must balance the interests of the Company and the
 16 interests of all customers.³⁰² Staff notes that currently, irrigation customers have the lowest
 17 commodity charge, that the disparity between the commodity rates of the classes should be
 18 minimized to encourage water conservation, and that Staff believes its approach is fair and balances
 19 the interests of the Company and its customers.³⁰³

20 Pacific Life argues that a similar proposed increase for Irrigation and Construction water
 21 customers was rejected in the Company’s last rate case.³⁰⁴ Staff states that each case that comes
 22 before the Commission requires independent analysis and a determination based on the facts of the
 23 specific case, and therefore the fact that the Commission considered and rejected a similar increase to
 24 irrigation customers in a prior case is not binding on a determination in this case.³⁰⁵ The Company

25
 26 ³⁰⁰ Pacific Life Brief at 4-6.

³⁰¹ Company Reply Brief at 20.

³⁰² Staff Reply Brief at 11.

³⁰³ *Id.*

³⁰⁴ Pacific Life Brief at 6.

³⁰⁵ *Id.*

1 also argues that Decision No. 68176 is not dispositive on the issue, and that Pacific Life offers no
 2 reason that the Company could not again raise the issue in this rate case for Commission
 3 consideration based on fair treatment of all its customers and to promote conservation.³⁰⁶

4 Pacific Life argues that without a cost-of-service study, there is no evidentiary basis to
 5 increase rates for one class of customers more than for another customer class.³⁰⁷ The Company
 6 disagrees, stating that it is not requesting a change to its rate design in this case, but is seeking to
 7 address what appeared to be an anomaly in its rate design, given the Commission's decision to adopt
 8 Staff's proposed inverted tier rate design in the last rate case for the purpose of promoting
 9 conservation.³⁰⁸ The Company contends that Pacific Life's assertions concerning the need for a cost
 10 of service study are unsupported and irrelevant, because the Company's current rate design is not
 11 based on a cost of service study. Staff contends that because the Company's proposed rate design is
 12 not different than the one approved in its last rate case, a cost of service study is not required.³⁰⁹

13 Pacific Life argues that the Company admits that test year revenues reflect that irrigation
 14 customers have already been successful in conserving water, and that "[t]here is no evidence that
 15 further conservation is needed, or even wise."³¹⁰ The Company states that it is proposing to raise the
 16 rate structure for Irrigation and Construction water because the current rate design is inconsistent
 17 with and contrary to the premise of the inverted tier rate design adopted in Decision No. 68176 to
 18 promote water conservation.³¹¹ The Company believes the Commission should consider whether it is
 19 appropriate to impose inverted tier rates on residential and commercial customers, while allowing
 20 Irrigation and Construction water customers to purchase potable water for landscape irrigation at a
 21 rate that is substantially below the first tier commodity rate applicable to other customers.³¹²

22 We agree with the Company that the current rates for potable irrigation water are inconsistent
 23 with and contrary to the premise of the inverted tier rate design adopted in Decision No. 68176 to
 24 promote water conservation. The disparity between the commodity rate for Irrigation and

25 ³⁰⁶ Company Reply Brief at 21.

26 ³⁰⁷ Pacific Life Reply Brief at 1-3.

26 ³⁰⁸ *Id.*

27 ³⁰⁹ *Id.*

27 ³¹⁰ Pacific Life Brief at 6-8; Pacific Life Reply Brief at 2.

28 ³¹¹ Company Reply Brief at 22.

28 ³¹² *Id.*

1 Construction water customers and other customers needs to be addressed, and the rate designs
 2 proposed by the parties fairly address the issue. While we are cognizant of the fact that bringing the
 3 Irrigation and Construction commodity rates closer to those for other customers will affect golf
 4 courses and other customers who purchase potable water for turf and landscape purposes and
 5 construction, we find that a correction to the rate design approved in Decision No. 68176 is in order.
 6 We will adopt the parties' proposals to charge Irrigation and Construction water customers the
 7 monthly minimum charges by meter size and a flat commodity rate equal to the first tier commodity
 8 rate for other commercial and industrial customers.

9 **B. Low Income Tariff**

10 Staff states that the Commission has approved low income tariffs for a number of utilities, and
 11 with the recent downturn in our economy, there is an even greater need for these types of tariffs.³¹³
 12 The Company has proposed a low income tariff to provide an opportunity for those customers that
 13 need assistance to lower their cost of water utility service. The Company proposes that customers
 14 meeting the necessary qualifications would receive a 15 percent discount off their water bill.³¹⁴ The
 15 primary criteria would be based on the combined gross annual income of all persons living in the
 16 household. For example, a 4-person household with a total gross annual income of less than or equal
 17 to \$31,800 would meet the criteria.³¹⁵ Customers would sign up for the program by completing an
 18 application and eligibility declaration and submitting proof of income to the Company.³¹⁶ The
 19 income guidelines are based on 150 percent of the 2008 federal poverty guidelines.³¹⁷ The Company
 20 would update its gross annual household income limits annually.³¹⁸

21 The program costs (the discounts given to participants plus a 10 percent fee for administration
 22 and carrying costs) would be recovered from non-participants via a commodity surcharge.³¹⁹ The
 23 Company would maintain a balancing account to keep track of the program costs and the collections
 24 made from non-participants, and the commodity surcharge to non-participants would begin one year

25 ³¹³ Staff Reply Br. at 13.

26 ³¹⁴ Supplemental Rebuttal Testimony of Company witness Thomas J. Bourassa (Exh. A-6) at 2.

27 ³¹⁵ *Id.*

27 ³¹⁶ *Id.*

27 ³¹⁷ *Id.*

28 ³¹⁸ *Id.* at 3.

28 ³¹⁹ *Id.*

1 after the program begins.³²⁰ CCWC will track the program costs for 12 months, and upon completion
 2 of the 12 month period, the Company will compute a surcharge intended to collect the prior year's
 3 program costs over the next 12 months.³²¹ CCWC would submit an annual report to the Commission
 4 showing the number of participants for the year, the discounts given to participants, administration
 5 fee and carrying costs, and the collection made from non-participants through the surcharge.³²²
 6 Based on the existing bill for median usage on a 3/4-inch meter currently at \$24.94, the low income
 7 program would result in a reduction of \$3.74.³²³ The surcharge impact for non-participants, based on
 8 the 2006 gallons sold, would be about 4 cents on the average 3/4-inch customer bill.³²⁴

9 Staff recommends that the Company's low income tariff proposal be adopted.³²⁵ Staff's
 10 recommendation is reasonable and will be adopted. We will direct the Company to file, along with
 11 the tariff of rates and charges approved herein, a copy of the Low Income Tariff it provided with its
 12 brief and reproduced and attached hereto as Exhibit A, and to implement the Low Income Tariff as
 13 described in the Supplemental Rebuttal Testimony of Company witness Thomas J. Bourassa (Exh. A-
 14 6).

15 C. Delay Surcharge Request

16 The Company proposes on brief that a "surcharge for delay" should be imposed on its
 17 customers to allow it to recover revenue increases it did not recover during the six-month stay of
 18 proceedings in this case granted at Staff's request pending the outcome of the Remand Proceeding.³²⁶
 19 The Company requests that the surcharge include "appropriate carrying costs."³²⁷ The Company
 20 contends that it should be compensated both for that delay and for the additional delay caused by
 21 Staff's decision to bring in an outside consultant three days prior to the hearing, and the subsequent
 22 bifurcation of the hearing to hear cost of capital issues separately from the other issues.³²⁸

23 Staff responds that while there were delays in this case, CCWC has not demonstrated, other

24 ³²⁰ *Id.*

25 ³²¹ *Id.*

26 ³²² *Id.* at 4.

27 ³²³ *Id.* at 5.

28 ³²⁴ *Id.* at 6.

³²⁵ Staff Brief at 14.

³²⁶ Company Brief at 26-27.

³²⁷ *Id.*

³²⁸ *Id.*

1 than by the assertions made on brief, any harm that should be ameliorated.³²⁹ Staff contends that
 2 delays can be common in rate cases where the issues are complex, and that the Company's ratepayers
 3 should not bear the burden of the delays.³³⁰ Staff argues that the surcharge proposed by the Company
 4 is not supported by the record and it should therefore be rejected.³³¹

5 After the parties made their arguments on the appropriateness of Staff's requested suspension
 6 of the Commission's Time Clock Rule³³² in this matter, a Procedural Order was issued in this case on
 7 January 22, 2008. The January 22, 2008, Procedural Order outlined the parties' positions and the
 8 consideration of the issue, and ultimately found that the timing of this rate case, in conjunction with
 9 the uncommon nature, and the timing, of the Remand Proceeding that was pending at the time,
 10 constituted an extraordinary circumstance, pursuant to A.A.C. R14-2-103(B)(11)(e)(ii), requiring
 11 suspension of the Timeclock Rule. The January 22, 2008, Procedural Order called for the hearing to
 12 continue in this proceeding as soon as practicable following the Commission's final order in the
 13 Remand Proceeding, and directed the parties to continue to conduct discovery and case preparation to
 14 the greatest extent possible during the duration of the continuance in order to minimize any delay in
 15 implementation of new rates pursuant to this application.

16 We agree with Staff that the Company has not demonstrated the "injury due to this delay" it
 17 alleges on brief. Neither has the Company quantified the extent of the alleged injury. The delay was
 18 necessary to resolve the issues in the Remand Proceeding, which directly affects this case. We agree
 19 with Staff that under the circumstances of this case, the Company's ratepayers should not be asked to
 20 bear any additional burden due to the extraordinary circumstances that led to the suspension of the
 21 Timeclock Rule in this proceeding, and will deny the Company's request.

22 * * * * *

23 Having considered the entire record herein and being fully advised in the premises, the
 24 Commission finds, concludes, and orders that:

25 . . .

26 _____
 27 ³²⁹ Staff Reply Brief at 6.

³³⁰ *Id.*

³³¹ *Id.*

28 ³³² A.A.C. R14-2-103(B)(11).

FINDINGS OF FACT

1
2 1. On September 26, 2007, CCWC filed a rate increase application with the Commission
3 based on a test year ended December 31, 2006.

4 2. On October 26, 2007, the Staff filed a letter finding the application sufficient and
5 classifying CCWC as a Class A utility.

6 3. By Procedural Order issued November 30, 2007, a hearing was set on the application
7 to commence on July 8, 2008, associated procedural deadlines were set, and intervention was granted
8 to RUCO.

9 4. On December 7, 2007, the Company filed a Request to Modify Procedural Schedule in
10 which the Company requested a continuation of the hearing due to a conflict on the part of counsel.

11 5. A telephonic procedural conference was held on December 13, 2007, for discussion of
12 the need for an extension of the deadline for a Commission Decision in this matter pursuant to
13 A.A.C. R14-3-103(B)(11) (the Commission's "Time Clock Rule") in conjunction with the
14 Company's requested schedule modification.

15 6. An Amended Rate Case Procedural Order was issued on December 19, 2007,
16 continuing the hearing on this matter from July 8, 2008, to July 21, 2008, and continuing associated
17 procedural deadlines.

18 7. On January 3, 2008, Staff filed a Motion to Suspend Time Clock.

19 8. On January 8, 2008, CCWC filed its Response in Opposition to the Motion to Suspend
20 Time Clock.

21 9. On January 10, 2008, RUCO filed its Response to the Utilities Division's Motion to
22 Suspend Time Clock.

23 10. On January 14, 2008, Staff filed its Reply to Company's Response to Staff's Motion
24 to Suspend Time Clock.

25 11. On January 22, 2008, a Procedural Order was issued granting Staff's Motion to
26 Suspend Timeclock. The Procedural Order continued the hearing pursuant to the Time Clock Rule,
27 and ordered that the hearing would be reset to continue as soon as practicable following the
28 Commission's final order in Docket No. W-02113A-04-0616, the remand of Decision No. 68176

1 (September 30, 2005), a pending matter in which the rates of CCWC were also being considered.
2 The Procedural Order directed all parties to continue to conduct discovery and case preparation to the
3 greatest extent possible during the duration of the continuance, in order to minimize any delay in
4 implementation of new rates pursuant to the application.

5 12. On January 24, 2008, the Company filed a Motion for Reconsideration by the
6 Commission of Procedural Order Staying Rate Application.

7 13. On January 28, 2008, Staff filed Staff's Response to Chaparral City Water Company's
8 Motion for Reconsideration.

9 14. On June 30, 2008, a Recommended Opinion and Order for Commission consideration
10 was filed in Docket No. W-02113A-04-0616.

11 15. On July 7, 2008, the Company filed a Notice of Implementation of Interim Rates
12 Pursuant to A.R.S. § 40-256.

13 16. On July 8, 2008, RUCO filed its Opposition to the Company's Implementation of
14 Interim Rates and Motion to Prohibit the Company from Implementing Interim Rates.

15 17. On July 11, 2008, the Company filed a Notice of Postponement of Implementation of
16 Interim Rates Pursuant to A.R.S. § 40-256.

17 18. On July 16, 2008, Staff filed Staff's Response to the Company's Notice of
18 Implementation of Interim Rates Pursuant to A.R.S. § 40-256 and Notice of Postponement. Therein,
19 Staff stated that it would oppose an attempt by the Company to notice and implement a rate increase
20 without an order by the Commission. Staff included legal arguments in support of its position, and
21 requested that a procedural conference be scheduled to address the issues raised by the Company's
22 notices regarding interim rates.

23 19. On July 17, 2008, at an Open Meeting of the Commission, the Commission voted to
24 adopt, as amended, the Recommended Opinion and Order filed in Docket No. W-02113A-04-0616
25 on June 30, 2008. The Commission subsequently issued Decision No. 70441 (July 28, 2008) in that
26 docket.

27 20. On July 18, 2008, a procedural order was issued setting a procedural conference for
28 the purpose of allowing the parties to discuss an appropriate procedural schedule, including the

1 resetting of a hearing date so that the case could proceed as quickly as possible, and to discuss the
2 Company's filings regarding the implementation of interim rates.

3 21. On July 21, 2008, the Procedural Conference was convened as scheduled. Counsel for
4 the Company, RUCO and Staff appeared and discussed procedural deadlines for the filing of Staff
5 and intervenor direct testimony and also briefly discussed their positions regarding the Company's
6 filings regarding implementation of interim rates. Counsel for RUCO withdrew its Motion to
7 Prohibit the Company from Implementing Interim Rates.

8 22. On July 24, 2008, a Second Amended Rate Case Procedural Order was issued,
9 continuing the hearing date to commence on December 8, 2008.

10 23. On September 4, 2008, the Company filed its Certification of Publication and Proof of
11 Mailing, indicating that it provided notice of the hearing as required.

12 24. On September 8, 2008, the Company submitted a Notice of Filing requesting, as
13 authorized in Decision No. 70441, recovery of the Company's rate case expense in connection with
14 the appeal and remand of Decision No. 68176.

15 25. Also on September 8, 2008, the Company filed a Motion for Approval of Interim
16 Rates (Expedited Action Requested).

17 26. On September 12, 2008, the Company filed a Request for Procedural Conference.

18 27. On September 23, 2008, Staff filed its Response to the Company's Motion for
19 Approval of Interim Rates.

20 28. On September 23, 2008, RUCO filed its Opposition to the Company's Motion for
21 Interim Rates.

22 29. On September 26, 2008, by procedural order, Pacific Life's September 15, 2008,
23 Motion to Intervene was granted.

24 30. On September 30, 2008, the Company filed its Reply in Support of Motion for
25 Approval of Interim Rates (Expedited Action Requested).

26 31. On September 30, 2008, a Procedural Order Extending Filing Deadlines was issued,
27 granting Staff's request to extend the deadline for Staff and intervenor direct testimony to October 3,
28 2008, and extending the deadline for intervenor surrebuttal testimony to November 20, 2008.

1 32. RUCO and Staff filed direct testimony on September 30, 2008, and October 3, 2008,
2 respectively.

3 33. On October 2, 2008, the Company filed its Second Request for Procedural
4 Conference.

5 34. On October 7, 2008, a procedural order was issued setting a procedural conference for
6 October 20, 2008, for the purpose of allowing the parties to discuss the Company's Motion for
7 Approval of Interim Rates.

8 35. A procedural conference was held as scheduled. The Company, RUCO and Staff
9 appeared through counsel. At the procedural conference, the Company stated that it wished to
10 proceed with the rate application in lieu of the alternative option of suspending the rate proceeding in
11 favor of proceeding to hearing on the Motion for Approval of Interim Rates.

12 36. On October 24, 2008, Staff filed a Notice of Filing of Meeting on Settlement, and on
13 October 28, 2008, Staff filed a Corrected Notice of Filing of Meeting on Settlement.

14 37. On October 31, 2008, the Company filed its rebuttal testimony, and filed supplemental
15 rebuttal testimony on November 19, 2008.

16 38. On November 12, 2008, Pacific Life filed a Notice of Appearance of Counsel,
17 indicating a change of counsel.

18 39. On November 20, 2008, RUCO filed surrebuttal testimony. An Errata thereto was
19 filed on November 25, 2008.

20 40. On November 20, 2008, Staff filed surrebuttal testimony of two witnesses.

21 41. On November 21, 2008, Staff filed a Notice of Witness Substitution and Request for
22 Procedural Order. Staff requested that it be allowed to file substitute witness Mr. Parcell's surrebuttal
23 testimony on cost of capital on December 3, 2008, and requested a date certain of December 15,
24 2008, for Mr. Parcell's live testimony.

25 42. On November 24, 2008, the Company filed its Response objecting to Staff's
26 November 21, 2008 filing.

27 43. On November 24, 2008, the Town of Fountain Hills filed a public comment letter
28 requesting that the Commission not approve the Company's requested rate increase.

1 44. On November 26, 2008, Staff filed a Reply to the Company.

2 45. On December 2, 2008, a Procedural Order was issued granting Staff's request to file
3 the surrebuttal testimony of its substitute witness on December 3, 2008, and indicating that the dates
4 certain requested by Staff for presentation of its expert witness were not available for hearing, but
5 that a suitable schedule for proceeding with the parties' presentation of their cases on cost of capital
6 would be discussed at the prehearing conference scheduled for December 5, 2008.

7 46. On December 3, 2008, Staff filed a Notice of Filing Surrebuttal Testimony of David
8 C. Parcell.

9 47. On December 4, 2008, the Company filed rejoinder testimony. An Errata thereto was
10 filed on December 5, 2008.

11 48. On December 5, 2008, the prehearing conference was held as scheduled. The
12 Company, RUCO and Staff appeared through counsel. Pacific Life did not enter an appearance. The
13 Company stated an objection to Staff's substitute witness Parcell's prefiled surrebuttal testimony, and
14 after discussion, Staff agreed to make a filing regarding Mr. Parcell's adoption of Staff witness
15 Chaves' testimony.

16 49. 241 written public comments were filed in opposition to the Company's requested rate
17 increase between August 20, 2008, and March 9, 2009.

18 50. On December 8, 2008, the hearing convened as scheduled. Prior to the presentation of
19 evidence, members of the public provided comments for the record. Commenters included Fountain
20 Hills Mayor Jay T. Schlum, Stephen Dausch, Marianne Wiggishoff, Richard V. Kloster, Richard
21 Baurle, Leona Johnston, Jerry Butler, Beth Mulcahy, and Ken Watkins. Commenters indicated a
22 concern that the proposed rate increase would affect homeowners in the Company's service area not
23 only by increasing individual homeowners' water bills, but also by increasing community
24 associations' water utility costs.³³³ Commenter Ken Watkins stated that he believes the Company's
25 rate proposal has an unfair effect on the Company's golf course customers.³³⁴

26 51. The Company, RUCO and Staff appeared at the hearing through counsel. Pacific Life
27

28 ³³³ Tr. at 6-23.

³³⁴ Tr. at 19-23.

1 did not appear. The Company, RUCO and Staff presented evidence and cross-examined witnesses on
2 all issues with the exception of cost of capital and rate of return. The hearing was recessed on
3 December 10, 2008, and was scheduled to reconvene on January 8 and 9, 2009, for the purpose of
4 taking evidence on the bifurcated issues of cost of capital and rate of return.

5 52. On December 9, 2008, Staff filed the portions of Pedro M. Chaves' direct testimony
6 adopted by David C. Parcell, and an Errata thereto was filed on December 15, 2008.

7 53. On December 11, 2008, Pacific Life filed a Motion for Leave to Present Testimony,
8 requesting leave to present testimony on the issue of the impact of the Company's proposed increase
9 in irrigation rates.

10 54 On December 16, 2008, the Company filed a Response to Pacific Life's Motion. The
11 Company opposed granting Pacific Life's request. The Company stated that the Motion was filed
12 substantially beyond the deadlines set for prefiled intervenor testimony, after the prehearing
13 conference, and following the completion of the hearing on all issues with the exception of the
14 bifurcated cost of capital and rate of return issues. The Company argued that Pacific Life had not
15 provided a legitimate basis for its request to file testimony at the late date, following the completion
16 of the parties' rate design witnesses' testimony. The Company further argued that the hearing had
17 already been delayed, and that allowing the requested untimely filing of rate design testimony would
18 prejudice the Company.

19 55. On December 17, 2008, RUCO filed its Response to the Motion. Therein, RUCO
20 requested that the current witness schedule not be disrupted, and stated that if Pacific Life's
21 testimony was allowed, RUCO reserved the right to present rebuttal testimony.

22 56. On December 17, 2008, Staff filed its Response to the Motion. Therein, Staff stated
23 that it was not opposed to the filing of testimony by Pacific Life's proposed witness, but that it would
24 reserve the right to recall its witness on rate design. Staff filed an Errata to its Response on
25 December 18, 2008.

26 57. On December 17, 2008, Pacific Life filed a Reply to the Company's Response to the
27 Motion. Pacific Life contended that presentation of the testimony of its witness would not delay this
28 case, because it was not asking to reopen the record, but wished to take advantage of an additional

1 hearing day that had already been scheduled.

2 58. On December 23, 2008, the Company filed supplemental rejoinder testimony on cost
3 of capital. An Errata thereto was filed on December 30, 2008.

4 59. On December 24, 2009, a Procedural Order was issued denying Pacific Life's Motion,
5 finding that granting the Motion would require reopening the completed first segment of the
6 bifurcated hearing, resulting in a time delay and prejudice to the parties, and that Pacific Life had
7 failed to avail itself of numerous opportunities to either conform to the same procedural schedule as
8 the other parties to this case, or to request accommodation in a timely manner.

9 60. On January 5, 2009, Staff filed a Notice of Filing Regarding Investigation. The Notice
10 stated that the CPUC had contacted Staff regarding a CPUC investigation of Golden States, an
11 affiliate of CCWC. The CPUC had alerted Staff that in the course of a CPUC investigation into
12 Golden States, the CPUC had discovered information relating to CCWC that it thought would be of
13 interest to Staff. The Notice stated that Staff was working with the CPUC on a confidentiality
14 agreement that would allow Staff to obtain information from the CPUC regarding the investigation.

15 61. On January 6, 2009, Staff filed a Notice of Filing to which was attached a copy of a
16 November 15, 2007, complaint filed in Los Angeles Superior Court against Golden States Water
17 Company, American States Water Company, et al.

18 62. On January 6, 2009, Staff filed proposed accounting order language for the treatment
19 of the deferred Municipal and Industrial charges related to the Company's 2997 CAP allocation
20 purchase.

21 63. On January 8, 2009, the hearing reconvened. The Company, RUCO and Staff
22 appeared, presented evidence, and cross-examined witnesses. The hearing concluded on January 9,
23 2009.

24 64. On January 13, 2009, RUCO filed a response to Staff's Proposed Accounting Order.

25 65. On January 16, 2009, the Company filed its Final Schedules. On February 13, 2009,
26 the Company filed a Notice of Errata that included corrected Final Schedules reflecting its final
27 position in this case regarding rate case expense.

28 66. On January 16, 2009, RUCO filed its Final Schedules.

1 67. On January 16, 2009, RUCO filed a Notice of Errata with corrections to Hearing
2 Exhibits R-17 and R-18.

3 68. On January 21, 2009, Staff filed its Final Schedules.

4 69. On January 21, 2009, the Company filed its Response to Staff's Proposed Accounting
5 Order.

6 70. On January 21, 2009, the Company, Pacific Life, RUCO, and Staff filed a Stipulation
7 to Extend Briefing Schedule.

8 71. On January 28, 2009, the Company, Pacific Life, RUCO, and Staff filed initial closing
9 briefs on all issues with the exception of cost of capital and rate of return.

10 72. On January 29, 2009, Staff filed a Notice of Filing. The Notice stated that on January
11 12, 2009, the Company had provided responses to Staff's data requests related to the CPUC
12 investigation of Golden States, and that based on the responses, Staff concluded that additional
13 discovery was necessary, and that Staff would continue to provide updates on the issue in this docket.

14 73. On February 10, 2009, Staff filed a Motion to Compel requesting that the Commission
15 order the Company to promptly provide information requested by Staff related to the CPUC
16 investigation of Golden States.

17 74. On February 13, 2009, the Company, Pacific Life, RUCO, and Staff filed reply briefs
18 on all issues with the exception of cost of capital and rate of return.

19 75. On February 13, 2009, the Company, RUCO, and Staff filed closing briefs on cost of
20 capital and rate of return.

21 76. On February 18, 2009, Staff docketed an update to its February 10, 2009, Motion to
22 Compel. Staff indicated that Staff and the Company had agreed to extend the time period in which
23 the Company has to respond, pending the outcome of ongoing negotiations to resolve the Motion to
24 Compel.

25 77. On February 27, 2009, the Company, RUCO and Staff filed reply briefs on cost of
26 capital and rate of return.

27 78. On March 4, 2009, the Company filed a Notice of Filing Late-Filed Exhibit. The
28 exhibit attached thereto is a rate case expense itemization spreadsheet showing a total for January

1 2007 - December 2008.

2 79. On June 3, 2009, a procedural order was issued directing Staff to file an update on its
3 Motion to Compel and the progress made in its discovery related to the CPUC investigation of
4 Chaparral City Water Company's parent, Golden States Water Company. The procedural order
5 directed Staff to include in the update a recommendation regarding an appropriate procedural means
6 of addressing the CPUC investigation issue, including whether it should be addressed in this docket.
7 The procedural order also directed the Company, Pacific Life, and RUCO to file responses to Staff's
8 update.

9 80. On June 11, 2009, Staff filed a Request for Extension of Time. Therein, Staff stated
10 that all three of the attorneys assigned to this case had time constraint conflicts with appellate matters
11 and settlement negotiations in other cases to which they are assigned that prevent them from meeting
12 the June 12, 2009 deadline.

13 81. On June 12, 2009, the Company filed a Response in Opposition to Staff's Motion for
14 Extension of Time. The Company objected to Staff's request for a one-week extension of time
15 because, according to the Company, the update is not needed. The Company argued that the Motion
16 to Compel is moot because the Company provided all the documents Staff requested by mid-March,
17 2009. The Company stated that it had offered to stipulate to either (1) keep this docket open, pending
18 conclusion of Staff's review of the CPUC investigation documents and a determination of whether
19 any further proceedings or relief are warranted, or (2) to open a new docket for the same purpose, but
20 that Staff had not definitively responded to the stipulation offer.

21 82. On June 17, 2009, RUCO filed a Response to Staff's Request for Extension of Time,
22 indicating support for Staff's request.

23 83. On June 17, 2009, a procedural order was issued granting a one week time extension
24 for Staff's update.

25 84. On June 19, 2009, Staff filed its Update and Reply to Chaparral City Water
26 Company's Response. Staff stated that ultimately, Staff and the Company had resolved their
27 discovery dispute through the execution of a protective agreement, upon which the Company
28 provided Staff with over 15,000 pages of documents. Staff stated that its investigation was ongoing,

1 and that Staff had not yet determined whether the Company's activities rise to the level of
2 impropriety or wrongdoing or impact the Company's rates or this pending rate case. Staff stated that
3 it had retained an outside consultant to assist in Staff's review of the documents and to determine
4 whether any alleged improprieties have impacts for this rate case. Staff stated that it found the
5 Company's stipulation proposal acceptable, as long as all parties acknowledge that rates could be
6 modified if the investigation yields circumstances which would warrant such action.

7 85. On June 23, 2009, RUCO filed its Response to Staff's Update Regarding the CPUC
8 Investigation. RUCO agrees that there has been insufficient time to review and analyze the
9 documentation which the Company produced on March 10, 13 and 16, 2009. RUCO stated that it
10 does not object to having this matter proceed, but with the docket remaining open subject to
11 reconsideration in the event that the investigation by Staff, RUCO, or the CPUC reflects impropriety
12 by Chaparral or its parent, officers or employees.

13 86. On June 25, 2009, the Company filed a Response to Staff's Update. The Company
14 asserted that there is no reason to delay rate relief, and requested the issuance of a decision in this
15 matter as soon as possible.

16 87. It is reasonable to require Staff to file by January 15, 2010, with docket control, as a
17 compliance item in this docket, a report documenting its review of the CPUC investigation
18 documents, and to require Staff to indicate in the report its findings and a recommendation regarding
19 whether any further proceedings or relief are warranted in this docket.

20 88. It is reasonable under the circumstances to make the rates approved herein interim
21 rates subject to modification in the event the ongoing Staff investigation reveals the existence of
22 circumstances which would warrant such action.

23 89. Under the circumstances of this case, it is not reasonable or in the public interest to
24 grant the Company's request for a "delay surcharge."

25 90. As discussed herein, an appropriate and reasonable capital structure for the Company
26 is 24 percent debt and 76 percent equity. The cost of debt is 5.0 percent, and an appropriate and
27 reasonable cost of equity is 9.9 percent.

28 91. In the test year ended December 31, 2006, the Company experienced Operating

1 Income of \$943,185, on total revenues of \$7,505,010 for a 3.52 percent rate of return on FVRB.

2 92. The Company requested rates that would result in total revenues of \$10,357,363, a
3 revenue increase of \$2,852,353, or 38.01 percent. RUCO recommended rates that would yield total
4 revenues of \$8,649,874, an increase of \$1,144,864 or 15.25 percent. Staff recommended total
5 revenues of \$9,350,843 an increase of \$1,904,143 or 25.57 percent.

6 93. As discussed herein, the Company's FVRB is determined to be \$26,776,414.

7 94. A FVROR on FVRB of 7.52 percent is reasonable and appropriate.

8 95. The revenue increase requested by the Company would produce an excessive return
9 on FVRB.

10 96. The Company's gross revenue should increase by \$1,764,371.

11 97. Under the Company's proposed rates, an average usage (8,400 gallons/month)
12 residential customer on a 3/4-inch meter would experience an increase of \$10.90, approximately 34
13 percent, from \$32.28 per month to \$43.27 per month.

14 98. Under the rates adopted herein, an average usage (8,400 gallons/month) residential
15 customer on a 3/4-inch meter would experience a monthly rate increase of \$5.14, approximately
16 15.88 percent, from \$32.37 per month to \$37.51 per month.

17 99. It is reasonable and in the public interest to correct the rate design disparity for
18 irrigation customers adopted in Decision No. 68176 by charging Irrigation and Construction water
19 customers the monthly minimum charges by meter size and a flat commodity rate equal to the first
20 tier commodity rate for other commercial and industrial customers.

21 100. The Company should be required to perform a monitoring exercise of its water system
22 as recommended by Staff, to docket the results by March 10, 2010, and to comply with the filing
23 requirements recommended by Staff and ordered herein, in the event the reported water loss is greater
24 than 10 percent. In no case should water loss be allowed to remain at 15 percent or greater.

25 101. The Company should be required to perform and submit a lead/lag study in
26 conjunction with its next rate application in order to meet the sufficiency requirements of that filing.

27 102. The property tax expense calculation methodology recommended by Staff is
28 reasonable and should be adopted.

1 103. Because CCWC acted prudently under the circumstances in its December, 2007, \$1.28
2 million purchase of the additional CAP allocation, the acquisition cost of the additional CAP
3 allocation should be included in rate base, classified as a plant-in-service component of Land and
4 Land Rights, and not subject to amortization.

5 104. CCWC should be allowed recovery of fifty percent of the CAP M&I charges related to
6 the additional CAP allocation, or \$20,306, as an operating expense.

7 105. CCWC should be allowed to defer, for possible later recovery through rates, the other
8 fifty-percent of its costs, excluding any interest or other carrying charges, incurred for the annual
9 CAP M&I charges.

10 106. CCWC should be authorized to create a deferral account to accrue these charges
11 beginning on January 1, 2008, which is the first time the CAP M&I charges are applicable according
12 to the contract.

13 107. The cost deferral authorization granted herein will allow consideration of, but not
14 guarantee recovery of these costs in future ratemaking proceedings.

15 108. CCWC should be required to prepare and retain accounting records sufficient to
16 permit detailed review of all deferred costs in a rate proceeding.

17 109. CCWC's deferral authority is limited to 48 months from January 1, 2008, unless
18 Chaparral City Water Company, Inc. has a general rate case pending at the end of the 48 month
19 period, in which case Chaparral City Water Company, Inc. may continue to defer these costs until
20 such rate case is concluded. Chaparral City Water Company, Inc. shall address the deferred amounts
21 recorded as of ninety days before the due date for filing Staff's Direct Testimony in the rate case.
22 Any additional properly deferred amounts recorded after that date may be considered in subsequent
23 rate case(s).

24 110. CCWC should be allowed to seek to include the accumulated deferred balance
25 associated with all amounts deferred pursuant to this Decision in the cost of service for rate-making
26 purposes in Chaparral City Water Company, Inc.'s next general rate case. Nothing in this Decision
27 shall be construed to limit this Commission's authority to review such balance and to make
28 disallowances thereof due to imprudence, errors or inappropriate application of the requirements of

1 this Decision.

2 111. This Decision should not be construed in any way to limit this Commission's authority
3 to review the entirety of the acquisition and to make any disallowances thereof due to imprudence,
4 error or inappropriate application of the requirements of this Decision.

5 112. ADEQ's formally delegated agent, the Maricopa County Environmental Services
6 Department ("MCESD") has determined that the CCWC drinking water system, PWS #07-017, is
7 currently delivering water that meets quality standards required by the Arizona Administrative Code,
8 Title 18, Chapter 4.

9 113. The Company's service territory is within the Phoenix Active Management Area
10 ("AMA"), and the Arizona Department of Water Resources ("ADWR") has reported that the
11 Company is in compliance with its requirements governing water providers.

12 114. The Company has no delinquent Arizona Corporation Commission compliance issues.

13 115. The Company has an approved curtailment plan tariff that became effective on
14 October 1, 2005.

15 116. The Company has an approved backflow prevention tariff that became effective on
16 October 1, 2005.

17 117. The Company should be required to use, on a going-forward basis, the depreciation
18 rates set forth at Table J-1 of the Engineering Report attached to the Direct Testimony of Staff
19 witness Marlin Scott, Jr.

20 CONCLUSIONS OF LAW

21 1. CCWC is a public service corporation pursuant to Article XV of the Arizona
22 Constitution and A.R.S. §§ 40-250 and 40-251.

23 2. The Commission has jurisdiction over CCWC and the subject matter of the
24 application.

25 3. Notice of the proceeding was provided in conformance with law.

26 4. The fair value of CCWC's rate base is \$26,776,414, and applying a 7.52 percent fair
27 value rate of return on this fair value rate base produces rates and charges that are just and reasonable.

28 5. The rates and charges approved herein are reasonable.

1 6. Administrative notice is taken of the complete record of Docket No. W-02113A-04-
2 0616.

3 7. It is reasonable to require Staff to file by January 15, 2010, with docket control, as a
4 compliance item in this docket, a report documenting its review of the CPUC investigation
5 documents, and to require Staff to indicate in the report its findings and a recommendation regarding
6 whether any further proceedings or relief are warranted in this docket and when interim rates become
7 permanent.

8 8. It is reasonable under the circumstances to make the rates approved herein interim
9 rates subject to modification in the event the ongoing Staff investigation reveals the existence of
10 circumstances which would warrant such action.

11 9. It is reasonable and in the public interest to require the Company to perform a
12 monitoring exercise of its water system as recommended by Staff, to docket the results by March 10,
13 2010, and to comply with the filing requirements recommended by Staff and ordered herein, in the
14 event the reported water loss is greater than 10 percent. It is reasonable and in the public interest to
15 require that in no case shall water loss be allowed to remain at 15 percent or greater.

16 10. It is reasonable and in the public interest to adopt the property tax expense calculation
17 methodology recommended by Staff.

18 11. It is reasonable and in the public interest to allow CCWC to defer fifty percent of the
19 CAP M&I charges subject to the requirements and conditions set forth herein.

20 12. It is reasonable and in the public interest to require CCWC to perform and submit a
21 lead/lag study in conjunction with its next rate adjustment request application in order to meet the
22 sufficiency requirements of that filing.

23 13. It is reasonable and in the public interest to correct the rate design disparity adopted in
24 Decision No. 68176 by charging Irrigation and Construction water customers the monthly minimum
25 charges by meter size and a flat commodity rate equal to the first tier commodity rate for other
26 commercial and industrial customers.

27 **ORDER**

28 IT IS THEREFORE ORDERED that Chaparral City Water Company, Inc. is hereby

1 authorized and directed to file with the Commission, on or before October 15, 2009, the following
 2 schedules of rates and charges, which shall be effective for all service rendered on and after October
 3 15, 2009:

4
 5 MONTHLY USAGE CHARGE:

6	3/4" Meter	\$ 16.50
	1" Meter	27.50
7	1 1/2" Meter	55.00
	2" Meter	88.00
8	3" Meter	176.00
	4" Meter	275.00
9	6" Meter	550.00
10	8" Meter	880.00
	10" Meter	1,265.00
11	12" Meter	2,365.00

12 Fire Hydrants Used for Irrigation Per Meter Size

13 Irrigation and Construction Per Meter Size

14
 15 Monthly Service Charge for Fire Sprinkler

16	4" or smaller Meter	10.00
	6" Meter	10.00
17	8" Meter	10.00
	10" or larger Meter	10.00

18
 19 COMMODITY RATES

20 Per 1,000 Gallons

(Residential, Commercial, Industrial)

3/4-inch Meter - Residential

21	0-3,000 Gallons	\$2.19
	3,001 - 9,000 Gallons	2.65
22	Over 9,000 Gallons	3.15

3/4-inch Meter - Commercial and Industrial

23	0 - 9,000 Gallons	2.65
24	Over 9,000 Gallons	3.15

1-inch Meter

25	0 to 24,000 Gallons	2.65
	Over 24,000 Gallons	3.15

26 1 1/2- inch Meter

27	0 to 60,000 Gallons	2.65
	Over 60,000 Gallons	3.15

28 2-inch Meter

1	0 to 100,000 Gallons	2.65
	Over 100,000 Gallons	3.15
2	3-inch Meter	
	0 to 225,000 Gallons	2.65
3	Over 225,000 Gallons	3.15
	4 - inch Meter	
4	0 to 350,000 Gallons	2.65
5	Over 350,000 Gallons	3.15
	6-inch Meter	
6	0 to 725,000 Gallons	2.65
	Over 725,000 Gallons	3.15
7	8 - inch Meter	
	0 to 1,125,000 Gallons	2.65
8	Over 1,125,000 Gallons	3.15
	10 -inch Meter	
9	0 to 1,500,000 Gallons	2.65
10	Over 1,500,000 Gallons	3.15
	12 - inch Meter	
11	0 to 2,250,000 Gallons	2.65
12	Over 2,250,000 Gallons	3.15
	Irrigation and Construction /Bulk –	
13	All Gallons	2.65
	Fire Hydrant Irrigation/Construction –	
14	All Gallons	2.65
15	Standpipe (Fire Hydrants) – All Gallons	2.65
16	Fire Sprinklers – All Gallons	2.65
17	<u>SERVICE CHARGES:</u>	
18	Establishment of Service:	
19	Regular Hours	\$25.00
	After Hours	35.00
20	Reestablishment of Service (within 12 months)	*
	Reconnection of Service (Delinquent):	
21	Regular Hours	35.00
22	After Hours	50.00
	Water Meter Test (If Correct)	35.00
23	Water Meter relocation at Customer Request	Cost
	(Per ACC Rule 14-2-405(B))	
24	Meter Re-Read (If Correct)	\$25.00
25	NSF Check Charge	25.00
	Late Fee Charge	1.5% per month
26	Deferred Payment Finance Charge	1.5% per month
	Service Call – After Hours	Refer to charges above
27	(Per ACC Rule 14-2-403(D))	
28	Deposit Requirements Residential	**

1 Deposit Requirements Non-Residential **
 2 Deposit Interest ***

3 * Monthly Minimum times Months Disconnected
 4 From the Water System
 5 (Per A.A.C. Rule 14-2-403(D))

6 **Residential – two times the average bill.
 7 Non-residential – two and one-half times the
 8 estimated maximum bill.

9 ***Interest per (Per ACC Rule 14-2-403(B)).

10 OFF-SITE FACILITIES HOOK-UP FEE:

11 5/8" x 3/4" Meter ****
 12 3/4" Meter ****
 13 1" Meter ****
 14 1 1/2" Meter ****
 15 2" Meter ****
 16 3" Meter ****
 17 4" Meter ****
 18 6" or Larger Meter ****

19 **** The fee shall be variable, fixed on January 1 of each calendar year, computed by
 20 dividing \$369,404.50 by the number of hook-ups during the previous calendar
 21 year. However, in no event shall the hook-up fee be higher than \$1,000 nor less
 22 than \$500.

23 2006 filing – New water installations. May be assessed only once per parcel,
 24 service connection, or lot within a subdivision. Purpose is to equitably
 25 apportion the costs of construction additional off-site facilities to provide water
 26 production, delivery, storage, and pressure among all new service connections.

27 SERVICE LINE AND METER INSTALLATION CHARGES:

	<u>Service Line</u>	<u>Meter Charge</u>	<u>Total Charge</u>
28 5/8" x 3/4" Meter	\$ 385.00	\$ 135.00	\$ 520.00
3 3/4" Meter	385.00	215.00	600.00
4 1" Meter	435.00	255.00	690.00
5 1-1/2" Meter	470.00	465.00	935.00
6 2" Turbine	630.00	965.00	1,595.00
7 2" Compound	630.00	1,690.00	2,320.00
8 3" Turbine	805.00	1,470.00	2,275.00
9 3" Compound	845.00	2,265.00	3,110.00
10 4" Turbine	1,170.00	2,350.00	3,520.00
11 4" Compound	1,230.00	3,245.00	4,475.00
12 6" Turbine	1,730.00	4,545.00	6,275.00
13 6" Compound	1,770.00	6,280.00	8,050.00
14 8" or Larger	At Cost	At Cost	At Cost

1 In addition to the collection of regular rates, the utility will collect
2 from its customers a proportionate share of any privilege, sales, use
and franchise tax. Per Commission Rule 14-2-408(D)(5).

3 All advances and/or contributions are to include labor, materials,
4 overheads, and all applicable taxes, including all gross-up taxes for
income taxes, if applicable.

5 IT IS FURTHER ORDERED that the Low Income Tariff attached hereto as Exhibit A is
6 hereby adopted and shall be included with the tariffs filed in accordance with the Ordering Paragraph
7 above.

8 IT IS FURTHER ORDERED that this docket shall remain open, pending conclusion of the
9 parties' review of the California Public Utilities Commission investigation documents.

10 IT IS FURTHER ORDERED that the rates approved herein are interim rates subject to
11 modification in the event the ongoing Staff investigation related to the California Public Utilities
12 Commission investigation documents reveals the existence of circumstances which would warrant
13 such action.

14 IT IS FURTHER ORDERED that Staff shall file by January 15, 2010, with Docket Control,
15 as a compliance item in this docket, a report documenting its review of the California Public Utilities
16 Commission investigation documents. The report shall indicate Staff's findings and a
17 recommendation regarding whether any further proceedings or relief are warranted in this docket.

18 IT IS FURTHER ORDERED that the property tax expense calculation methodology
19 recommended by Staff is hereby adopted

20 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. shall begin a 12-
21 month monitoring exercise of its water system after the Company completes its own Central Arizona
22 Project water meter installation, and shall docket the results of the system monitoring as a compliance
23 item in this case by March 1, 2010. If the reported water loss for the period from February 1, 2009
24 through February 1, 2010 is greater than 10 percent, the Company shall prepare, and file, by April 30,
25 2010, as a compliance item for this proceeding for review and certification by Staff, a report
26 containing a detailed analysis and plan to reduce water loss to 10 percent or less, or alternatively, if
27 the Company believes it is not cost effective to reduce water loss to less than 10 percent, the
28

1 Company shall submit a detailed cost benefit analysis to support its opinion. In no case shall water
2 loss be allowed to remain at 15 percent or greater.

3 IT IS FURTHER ORDERED that because Chaparral City Water Company, Inc. acted
4 prudently under the circumstances in its December, 2007, \$1.28 million purchase of the additional
5 Central Arizona Project allocation, the acquisition cost of the additional allocation should be included
6 in rate base, classified as a plant-in-service component of Land and Land Rights, and not subject to
7 amortization.

8 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. shall be allowed
9 recovery of fifty percent of the Central Arizona Project Municipal and Industrial charges related to
10 the additional Central Arizona Project allocation, or \$20,306, as an operating expense in this case.

11 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. is hereby authorized
12 to defer, for possible later recovery through rates, the remaining fifty-percent of its costs, excluding
13 any interest or other carrying charges, incurred for the annual Central Arizona Project Municipal and
14 Industrial charges, and absolutely nothing in this Decision shall be construed in any way to limit this
15 Commission's authority to review the entirety of the acquisition and to make any disallowances
16 thereof due to imprudence, error or inappropriate application of the requirements of this Decision.

17 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. is authorized to create
18 a deferral account to accrue the authorized deferral charges beginning on January 1, 2008, which is
19 the first time the Municipal and Industrial charges are applicable according to the contract.

20 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. shall prepare and
21 retain accounting records sufficient to permit detailed review, in a rate proceeding, of all deferred
22 costs recorded as authorized above.

23 IT IS FURTHER ORDERED that the cost deferral authorization granted herein will allow
24 consideration of, but not guarantee recovery of these costs in future ratemaking proceedings.

25 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc.'s deferral authority is
26 limited to 48 months from January 1, 2008, unless Chaparral City Water Company, Inc. has a general
27 rate case pending at the end of the 48 month period, in which case Chaparral City Water Company,
28 Inc. may continue to defer these costs until such rate case is concluded. Chaparral City Water

1 Company, Inc. shall address the deferred amounts recorded as of ninety days before the due date for
2 filing Staff's Direct Testimony. Any additional properly deferred amounts recorded after that date
3 may be considered in subsequent rate case(s).

4 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. may seek to include
5 the accumulated deferred balance associated with all amounts deferred pursuant to this Decision in
6 the cost of service for rate-making purposes in Chaparral City Water Company, Inc.'s next general
7 rate case. Nothing in this Decision shall be construed to limit this Commission's authority to review
8 such balance and to make disallowances thereof due to imprudence, errors or inappropriate
9 application of the requirements of this Decision.

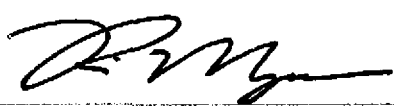

10 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. shall perform and
11 submit a lead/lag study in conjunction with its next rate adjustment request application in order to
12 meet the sufficiency requirements of that filing.

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1 IT IS FURTHER ORDERED that administrative notice is hereby taken in this docket of the
2 complete record of Docket No. W-02113A-04-0616.

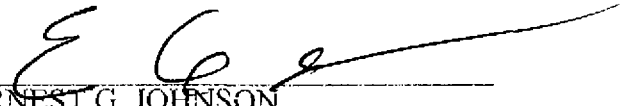
3 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

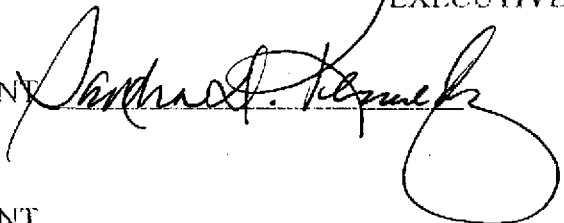
4 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

5 
6 CHAIRMAN  COMMISSIONER

7  COMMISSIONER  COMMISSIONER
8  COMMISSIONER
9

10
11 IN WITNESS WHEREOF, I, ERNEST G. JOHNSON,
12 Executive Director of the Arizona Corporation Commission,
13 have hereunto set my hand and caused the official seal of the
14 Commission to be affixed at the Capitol, in the City of Phoenix,
15 this ~~Oct~~ day of October 2009.
16 21st

17 
18 ERNEST G. JOHNSON
19 EXECUTIVE DIRECTOR

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17 DISSENT 
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19 DISSENT _____

1 SERVICE LIST FOR: CHAPARRAL CITY WATER COMPANY, INC.

2 DOCKET NO.: W-02113A-07-0551

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EXHIBIT A

**CHAPARRAL CITY WATER COMPANY (CCWC)
ALTERNATE RATES FOR WATER (ARW)
DOMESTIC SERVICE – SINGLE FAMILY ACCOMMODATION**

APPLICABILITY

Applicable to residential water service for domestic use rendered to low-income households where the customer meets all the Program Qualifications and Special Conditions of this rate schedule.

TERRITORY

Within all Customer Service Areas served by the Company.

RATES

Fifteen percent (15%) discount applied to the regular filed tariff.

PROGRAM QUALIFICATIONS

1. The CCWC bill must be in your name and the address must be your primary residence or you must be a tenant receiving water service by a sub-metered system in a mobile home park.
2. You may not be claimed as a dependent on another person's tax return.
3. You must reapply each time you move.
4. You must renew your application every two years, or sooner, if requested.
5. You must notify CCWC within 30 days if you become ineligible for ARW.
6. Your total gross annual income of all persons living in your household cannot exceed the income levels below:

Effective October 15, 2009

<u>No. of Person In Household</u>	<u>Total Gross Annual Income</u>
1	\$15,600
2	21,000
3	26,400
4	31,800
5	37,200
6	42,600

For each additional person residing in the household, add \$5,400.

(Continued)

EXHIBIT A

For the purpose of the program the "gross household income" means all money and non cash benefits, available for living expenses, from all sources, both taxable and non taxable, before deductions for all people who live in my home. This includes, but is not limited to:

Wages or salaries	Social Security, SSI, SSP	Rental or royalty income
Interest or dividends from:	Scholarships, grants, or other aid	Profit from self-employment
Savings accounts, stocks or bonds	used for living expenses	(IRS form Schedule C, Line 29)
Unemployment benefits	Disability payments	Worker's Compensation
TANF(AFDC)	Food Stamps	Child Support
Pensions	Insurance settlements	Spousal Support
Gifts		

SPECIAL CONDITIONS

1. **Application and Eligibility Declaration:** An Application and eligibility declaration on a form authorized by the Commission is required for each request for service under this schedule. Renewal of a customer's eligibility declaration will be required, at least, every two years.
2. **Commencement of Rate:** Eligible customers shall be billed on this schedule commencing with the next regularly scheduled billing period that follows receipt of application by the Utility.
3. **Verification:** Information provided by the applicant is subject to verification by the Utility. Refusal or failure of a customer to provide documentation of eligibility acceptable to the Utility, upon request by the Utility, shall result in removal from this rate schedule.
4. **Notice From Customer:** It is the customer's responsibility to notify the Utility if there is a change of eligibility status.
5. **Rebilling:** Customers may be re-billed for periods of ineligibility under the applicable rate schedule.
6. **Mobile home Park and Master-metered:** A reduction will be calculated in the bill of mobile home park and master-metered customers, who have sub-metered tenants that meet the income eligibility criteria, so an equivalent discount (15%) can be passed through to eligible customer(s).