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AZ CORP COMMISSION
DOCKET CONTROL

BEFORE THE ARIZONA CORPORATION COMMISSION

8 IN THE MATTER OF THE APPLICATION
 9 OF LITCHFIELD PARK SERVICE
 COMPANY, AN ARIZONA
 10 CORPORATION, FOR A
 DETERMINATION OF THE FAIR VALUE
 11 OF ITS UTILITY PLANTS AND
 PROPERTY AND FOR INCREASES IN ITS
 12 WASTEWATER RATES AND CHARGES
 FOR UTILITY SERVICE BASED
 13 THEREON.

DOCKET NO: SW-01428A-09-0103

14 IN THE MATTER OF THE APPLICATION
 OF LITCHFIELD PARK SERVICE
 15 COMPANY, AN ARIZONA
 CORPORATION, FOR A
 16 DETERMINATION OF THE FAIR VALUE
 OF ITS UTILITY PLANTS AND
 17 PROPERTY AND FOR INCREASES IN ITS
 WATER RATES AND CHARGES FOR
 18 UTILITY SERVICE BASED THEREON.

DOCKET NO: W-01427A-09-0104

19 IN THE MATTER OF THE APPLICATION
 20 OF LITCHFIELD PARK SERVICE
 COMPANY, AN ARIZONA
 21 CORPORATION, FOR AUTHORITY (1) TO
 22 ISSUE EVIDENCE OF INDEBTEDNESS IN
 AN AMOUNT NOT TO EXCEED \$1,755,000
 23 IN CONNECTION WITH (A) THE
 CONSTRUCTION OF TWO RECHARGE
 24 WELL INFRASTRUCTURE
 IMPROVEMENTS AND (2) TO
 25 ENCUMBER ITS REAL PROPERTY AND
 PLANT AS SECURITY FOR SUCH
 26 INDEBTEDNESS.

DOCKET NO. W-01427A-09-0116

Arizona Corporation Commission

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IN THE MATTER OF THE APPLICATION
OF LITCHFIELD PARK SERVICE
COMPANY, AN ARIZONA
CORPORATION, FOR AUTHORITY (1) TO
ISSUE EVIDENCE OF INDEBTEDNESS IN
AN AMOUNT NOT TO EXCEED \$1,170,000
IN CONNECTION WITH (A) THE
CONSTRUCTION OF ONE 200 KW ROOF
MOUNTED SOLAR GENERATOR
INFRASTRUCTURE IMPROVEMENTS
AND (2) TO ENCUMBER ITS REAL
PROPERTY AND PLANT AS SECURITY
FOR SUCH INDEBTEDNESS.

DOCKET NO. W-01427A-09-0120

LITCHFIELD PARK SERVICE COMPANY
INITIAL CLOSING BRIEF

February 10, 2010

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TABLE OF ABBREVIATIONS AND CONVENTIONS

1 Litchfield Park Service Company uses the following abbreviations in citing to the
 2 pre-filed testimony and hearing transcripts in this brief. Other documents that were
 3 admitted as exhibits during the hearing are cited by hearing exhibit number. The parties'
 4 final schedules setting forth their respective final positions will be cited in abbreviated
 5 format as follows: Company Final Schedule XXX, Staff Final Schedule XXX; RUCO
 6 Final Schedule XXX.* Other citations to testimony and documents are provided in full,
 7 including (where applicable) the Corporation Commission's docket number and filing
 8 date.

**LITCHFIELD PARK SERVICE COMPANY
 PRE-FILED TESTIMONY**

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Direct Testimony of Greg Sorensen	A-1	Sorensen Dt.
Amended Rebuttal Testimony of Greg Sorensen	A-2	Sorensen Amended Rb.
Rejoinder Testimony of Greg Sorensen	A-3	Sorensen Rj.
Rebuttal Testimony of Brian McBride	A-4	McBride Rb.
Rejoinder Testimony of Brian McBride	A-5	McBride Rj.
Rejoinder Testimony of Gerald Tremblay	A-9	Tremblay Rj.
Direct Testimony of Tom Bourassa (Rate Base)	A-14	Bourassa Dt.
Direct Testimony of Tom Bourassa (Cost of Capital)	A-15	Bourassa COC Dt.
Amended Rebuttal Testimony of Tom Bourassa (Rate Base)	A-16	Bourassa Amended Rb.
Rebuttal Testimony of Tom Bourassa (Cost of Capital)	A-17	Bourassa COC Rb.
Rejoinder Testimony of Tom Bourassa (Rate Base)	A-18	Bourassa Rj.

* LPSCO filed its Final Schedules on February 1, 2010.

1	Pre-Filed Testimony	Hearing Exhibit	Abbreviation
2	Rejoinder Testimony of Tom	A-19	Bourassa COC Rj.
3	Bourassa (Cost of Capital)		

**RESIDENTIAL UTILITY CONSUMER OFFICE
PRE-FILED TESTIMONY**

7	Pre-Filed Testimony	Hearing Exhibit	Abbreviation
8	Direct Testimony of Sonn Rowell	R-15	S. Rowell Dt.
9	Surrebuttal Testimony of Sonn Rowell	R-16	S. Rowell Sb.
10	Direct Testimony of Matt Rowell	R-22	M. Rowell Dt.
11	Surrebuttal Testimony of Matt Rowell	R-23	M. Rowell Sb.
12	Direct Testimony of William Rigsby	R-27	Rigsby Dt.
13	Direct Testimony of William Rigsby	R-28	Rigsby COC Dt.
14	(Cost of Capital)		
15	Surrebuttal Testimony of William Rigsby	R-29	Rigsby Sb.

**STAFF
PRE-FILED TESTIMONY**

20	Pre-Filed Testimony	Hearing Exhibit	Abbreviation
21	Direct Testimony of Pedro Chaves	S-2	Chaves Dt.
22	Surrebuttal Testimony of Pedro Chaves	S-3	Chaves Sb.
23			
24	Direct Testimony of Marlin Scott, Jr.	S-5	Scott Dt.
25	Surrebuttal Testimony of Marlin Scott, Jr.	S-6	Scott Sb.

	Pre-Filed Testimony	Hearing Exhibit	Abbreviation
1			
2	Direct Testimony of Juan C. Manrique	S-12	Manrique Dt.
3			
4	Surrebuttal Testimony of Juan C. Manrique	S-13	Manrique Sb.
5			
6	Direct Testimony of Jeffrey M. Michlik (Water)	S-14	Michlik Water Dt.
7	Surrebuttal Testimony of Jeffrey M. Michlik (Water)	S-15	Michlik Water Sb.
8			
9	Direct Testimony of Jeffrey M. Michlik (Sewer)	S-16	Michlik Wastewater Dt.
10	Surrebuttal Testimony of Jeffrey M. Michlik (Sewer)	S-17	Michlik Wastewater Sb.
11			
12			

**CITY OF LITCHFIELD PARK
PRE-FILED TESTIMONY**

	Pre-Filed Testimony	Hearing Exhibit	Abbreviation
13			
14			
15			
16	Direct Testimony of Richard Darnall	LP-2	Darnall Dt.
17	Surrebuttal Testimony of Richard Darnall	LP-3	Darnall Sb.
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OTHER PORTIONS OF THE RECORD

Document	Hearing Exhibit	Abbreviation
Hearing Transcript January 5-8, 11, 14 and 15, 2010	--	Tr.
Hearing Transcript Public Comment on January 4, 2010	--	Tr. (PC)
Analysis of Shared Services Model in Comparison to Stand Alone	A-10	
(Amended) Corporate Cost Allocation Comparative Cost Per Customer Analysis	A-11	
Allocation Methodology Analysis	A-12	
Decision No. 71447	A-13	
List of Stipulated Facts (as amended)	A-23	
Response to RUCO MJR 3.7	A-25	
Deposition Transcript of M. Rowell	A-28	
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Company Response to RUCO Data Request MJR 5.4	A-36	
Estimate of Retirement Costs	A-39	
Phase-In Calculation (Draft)	A-40	
Draft 2006 Evaluation Report	R-2	
ADEQ APP other amendment	R-5	
NARUC Waste Water System of Accounts Capital/Expense	R-20	
NARUC System of Accounts Water Capital/Expense	R-21	
Comparison of Water Rates	LP-4	
2282838		

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INTRODUCTION

LPSCO is Liberty Water’s largest utility, providing water and sewer service to over 30,000 combined water and wastewater customers in a portion of the Phoenix metro area’s west valley. This is the first rate case for LPSCO since it was acquired by Algonquin Water Resources of America, now known as Liberty Water, and it is a rate case driven by more than \$50 million of new rate base since the last time rates were set. As a consequence, after a few years of below cost rates, ratepayers are now facing rate increases which are needed so the Company can function as a going concern and have the opportunity to earn a rate of return on its investment. These rate increases are necessary to provide LPSCO recovery of its cost of service, which includes its reasonable and prudent operating expenses and a fair return on fair value rate base. Although LPSCO has not seen a rate increase in eight years, some ratepayer concerns were heard about the magnitude of the increase. In response to the concerns expressed by ratepayers, and at the Chairperson’s request, LPSCO has proposed a phase-in that would, if adopted, help mitigate the impact of the required rate increases. This phase-in, along with all of the other issues to be adjudicated in this rate case, are addressed below.¹

OVERVIEW OF LPSCO AND ITS REQUEST FOR RATE RELIEF

LPSCO’s service territory is located in the southwestern portion of the Phoenix metropolitan area and includes the Town of Litchfield Park, roughly half of the City of Goodyear, a small section in the City of Avondale, and some unincorporated portions of Maricopa County.² During the test year, LPSCO had approximately 15,600 water and

¹ The key for abbreviations and citations to a witness’ pre-filed testimony are set forth in the Table of Abbreviations and Conventions in pages iv to vii above following the Table of Contents. The table also lists the hearing exhibit numbers of the parties’ pre-filed testimony. Other hearing exhibits are cited by the hearing exhibit number and, where applicable, by page number, e.g., R-13 at 2. The transcript of the hearings is cited by page number, e.g., Tr. at 1.

² Sorensen Dt. at 2 – 5.

1 14,600 sewer service connections, but the water and wastewater CCNs are not identical.
2 The Company's customer base is predominantly residential, there are under 600
3 commercial and just over 650 irrigation water service customers, and the wastewater
4 division serves just over 300 non-residential customers.³ Goodyear also buys water from
5 LPSCO on a bulk basis for resale to its municipal water customers.⁴

6 The Company's water supply is entirely comprised of groundwater.⁵ LPSCO's
7 service territory is within the Phoenix Active Management Area, making the Company
8 subject to certain water conservation requirements imposed by the Third Management
9 Plan, adopted by the Arizona Department of Water Resources in order to reduce
10 groundwater pumping. This area is also located within the MAG 208 Planning area,
11 which subjects the location of wastewater treatment facilities to an additional layer of
12 regulation.⁶ LPSCO has a 4.1 MGD wastewater treatment plant using Sequential Batch
13 Reactor technology known as the PVWRF. The facility holds an APP from ADEQ that
14 allows for a potential expansion to a total of 8.2 MGD.⁷ The plant currently produces A+
15 effluent. Effluent is sold to local golf courses, construction companies, and farms, with
16 residual unsold effluent discharged to the RID canal and farm fields (when the RID is shut
17 down for 2 weeks each year for maintenance).⁸ LPSCO is in compliance with all
18 applicable laws and regulations, including the requirements imposed by Maricopa County
19 and the Commission.⁹ Notably, while two public comment sessions were held, public
20 comment was not focused on any service quality issues.

21 _____
³ Company Final Schedule H-2 (water and wastewater).

22 ⁴ *E.g.*, Sorensen Dt. at 13:9 – 14:2; Tr. at 1374:14-25.

23 ⁵ Sorensen Dt. at 2 – 5.

24 ⁶ *Id.*

25 ⁷ *Id.*

26 ⁸ *Id.*

⁹ Scott Dt. at Executive Summary: Conclusions (water and wastewater).

1 LPSCO's current rates were approved in Decision No. 65436 (December 9, 2002)
2 based on a December 31, 2000 test year. At that time, the Company had 5,541 water
3 customers and 5,012 wastewater customers, roughly one-third of its current customer
4 count. In other words, LPSCO has essentially tripled its customer base in an eight-year
5 period. Most of this growth occurred after the Company's stock was acquired by Liberty
6 Water, in February 2003. This will be the first rate case since LPSCO was acquired by
7 Liberty Water. This will also be the first time LPSCO's cost of service will include a
8 return on more than \$50 million of used and useful water and sewer plant.¹⁰ Such major
9 plant improvements include the PVWRF, new wells and storage, and arsenic treatment
10 facilities, among other plant facilities.¹¹ These substantial improvements are largely
11 responsible for the significant but necessary rate increases sought by the Company in this
12 rate case.¹²

13 The Company's application was filed on March 9, 2009 seeking a finding of fair
14 value rate base and the setting of rates thereon for both water and wastewater utility
15 service. During the test year, LPSCO's adjusted gross revenues were \$6,475,002 from
16 water utility service and \$6,356,372 from wastewater utility service.¹³ The adjusted
17 operating income (loss) for the water division was \$(282,894), leading to an operating
18 income deficiency of \$4,610,812. The adjusted operating income from the wastewater
19 division was \$163,959, leading to an operating income deficiency of \$3,072,724. Thus,
20 the rate of return on the Company's water operations during the test year was a negative
21 0.75 percent, and the rate of return on the Company's wastewater operations during the
22 test year was 0.58 percent.¹⁴

23 ¹⁰ Tr. at 39:5-12.

24 ¹¹ Sorensen Dt. at 6 – 13.

25 ¹² *Id.* at 5:17 – 6:6; Tr. at 37:12 – 38:13.

26 ¹³ Bourassa Dt. at Schedule A-1 (water and wastewater).

¹⁴ *Id.*

1 In its Final Schedules, the Company requests revenue requirements of \$13,680,114
2 from water utility service and \$11,161,394 in revenues from sewer utility service.¹⁵ These
3 proposed revenue requirements are based on water and wastewater fair value rate bases
4 equal to \$37,762,676 and \$28,222,289, respectively, total operating expenses of \$9,522,44
5 and \$8,054,120 for the water and wastewater divisions, and a weighted average cost of
6 capital equal to 11.01 percent.¹⁶ The Company's final proposed rates by class are
7 reflected in LPSCO's Final "H" Schedules, as is the Company's proposed low-income
8 tariff. The Company's rate design reflects the agreement reached during the hearing with
9 the City.

10 ARGUMENT

11 I. SUMMARY OF ISSUES ADDRESSED

12 A. Overview of Rate Base, Revenue Requirement and Rate Design Issues

13 LPSCO, RUCO and Staff were successful in reducing the number of issues in
14 dispute in this rate case.¹⁷ With respect to plant in service, for example, the parties were
15 able to reach agreement on the starting point for rate base following a black-box
16 settlement in the last rate case, as well as the AIAC and CIAC balances. Agreement was
17 also reached on the removal of debt issuance costs from rate base and the retirement of
18 several plant items from both divisions. Regarding revenues and expenses, the parties
19 reached agreement on the inclusion of test year revenues from bulk water sales to
20 Goodyear and agreed to the methodology for determining property taxes, among other
21 expense adjustments. Staff, RUCO and LPSCO also agree on the appropriate capital
22 structure. Additional agreements were reached between the Company and Staff, including

23 ¹⁵ Company Final Schedule A-1 (water and wastewater).

24 ¹⁶ *Id.*

25 ¹⁷ All of the "agreements" summarized herein are reflected in the parties' Final Schedules. The City did
26 not present evidence and did not take a position regarding rate base, revenues and expenses, or cost of
capital. Tr. at 666:3-14.

1 agreements on bad debt expense and normalization of costs for purchased power, while
2 the Company and RUCO reached agreement on recovery of a deferred regulatory asset
3 despite a difference as to the amount and on the methodology for determining deferred
4 income taxes. Finally, all parties, including the City, are in agreement regarding the
5 wastewater rate design and the approval of a low income tariff, while LPSCO and the City
6 have jointly proposed a rate design for the water division. Of course, significant issues
7 remain in dispute.

8 Undoubtedly, the most significant issue relating to rate base in dispute in this case
9 is RUCO's \$3.2 million disallowance of plant upgrade costs. Additional rate base issues
10 in dispute include RUCO's adjustments for "excess" capacity, capitalized affiliate labor
11 and expensed plant, and Staff's adjustments for security deposits and rejection of the
12 deferred regulatory asset related to costs associated with nearby groundwater
13 contamination caused by Crane Co. Unfortunately, Staff and the Company also disagree
14 over accumulated deferred income taxes. The most contested expense recovery issue in
15 this rate case involved the Company's "Central Cost" allocation and whether these costs
16 are incurred for shareholders or utilities. Staff, RUCO and the Company also disagree
17 over "performance or incentive" based compensation and the level and amortization of
18 rate case expense, while LPSCO and RUCO disagree over bad debt expense and "non-
19 recurring" expenses. None of the parties agree regarding the recommended return on
20 equity. Finally, the City and LPSCO join in opposing the rate designs recommended by
21 Staff and RUCO. Each of these disputed issues is addressed in this brief.

22 **B. Overview of Legal Issues**

23 During public comment, Chairperson Mayes asked the parties to address "the
24 impact of the economy on this case and what impact and what weight the Commission
25
26

1 should give the economy” in adjudicating the Company’s application.¹⁸ The Chairperson
2 also asked that the parties address phase-in proposals during the evidentiary portion of the
3 case. LPSCO responded to Chairperson Mayes’ request. The Company’s senior
4 management representative testified regarding the economy and the weight it should be
5 given.¹⁹ The Company also presented a phase-in proposal during the evidentiary hearing,
6 again, in direct response to the Chair’s specific request.²⁰ In addition to the evidentiary
7 aspect of these two issues, there are legal issues that must be taken into account.

8 1. The Legal Framework for Ratemaking in Arizona.

9 In Arizona, the Commission is responsible for setting “just and reasonable” rates
10 and charges for utility services furnished by utilities.²¹ The process followed by the
11 Commission in setting rates that are “just and reasonable” has been summarized as
12 follows:

13 The general theory of utility regulation is that total revenue,
14 including income from rates and charges, should be sufficient
15 to meet a utility’s operating costs and to give the utility and
16 its stockholders a reasonable rate of return on the utility’s
17 investment. To achieve this, the Commission must first
18 determine the “fair value” of a utility’s property and use this
19 value as the utility’s rate base. The Commission then must
20 determine what the rate of return should be, and then apply
21 that figure to the rate base in order to establish just and
22 reasonable tariffs.²²

23 ¹⁸ Tr. (PC) at 34:8-14.

24 ¹⁹ Tr. at 39:16 – 53:12.

25 ²⁰ See Ex. A-40. RUCO provided an alternative phase-in in its Final Schedules. The Company will accept
26 either of its proposed phase-ins. However, as explained below, RUCO’s proposed phase-in is unlawful
because it does not make the Company whole. See Section V, *infra*.

²¹ See Ariz. Const. Art. 15, § 3.

²² *Scates v. Ariz. Corp. Comm’n*, 118 Ariz. 531, 533-34, 578 P.2d 612, 614-15 (App. 1978) (citations
omitted). See also *US West Comm., Inc. v. Ariz. Corp. Comm’n*, 201 Ariz. 242, 244, 34 P.3d 351, 353,
¶ 13 (2001) (The “fair value [of the utility’s plant and property] has been the factor by which a reasonable
rate of return [is] multiplied to yield, with the addition of operating expenses, the total revenue that a
corporation could earn.”) (citing *Scates*).

1 Nearly 100 years of decisions by Arizona courts have required the Commission to
2 set rates that will produce sufficient revenue to allow the utility to recover its operating
3 expenses and earn a reasonable rate of return on the fair value of its property devoted to
4 public service.²³ Thus, as the Arizona Court of Appeals explained in *Scates*:

5 [T]he rates established by the Commission should meet the
6 overall operating costs of the utility and produce a reasonable
7 rate of return. It is equally clear that the rates cannot be
8 considered just and reasonable if they fail to produce a
reasonable rate of return or if they produce revenue which
exceeds a reasonable rate of return.²⁴

9 This is all LPSCO seeks in this case, no more and no less.

10 While the starting point of a permanent rate application is the utility's actual,
11 recorded results during the test year, those results must be adjusted to obtain a normal and
12 more realistic relationship between rate base, revenue and expenses that will be
13 representative of the period *when the new rates are in effect*. The Commission's
14 regulation defining the filing requirements in support of a proposed increase in rates and
15 charges for service specifically contemplates consideration of post-test year
16 circumstances. For example, the term "pro forma adjustments" is defined as:

17 Adjustments to actual test year results and balances to obtain
18 a normal or more realistic relationship between revenues,
expenses and rate base.²⁵

19 The process and procedures the Commission follows to gather and consider
20 evidence in setting rates are quasi-judicial in character. Perhaps the clearest statement of
21 the Commission's duties is found in *State ex rel. Corbin v. Ariz. Corp. Comm'n*, 143 Ariz.
22 219, 223-24, 693 P.2d 362, 366-67 (App. 1984), which explained:

23 _____
24 ²³ See *US West*, 201 Ariz. at 246, 578 P.2d at 355, ¶ 18 ("a line of cases nearly as old as the state itself has
sustained the traditional formulaic approach" to setting rates).

25 ²⁴ *Scates*, 118 Ariz. at 534, 578 P.2d at 615.

26 ²⁵ A.A.C. R14-2-103(A)(3)(i).

1 [A proceeding to fix rates] carries with it fundamental
2 procedural requirements. There must be a full hearing. There
3 must be evidence adequate to support pertinent and necessary
4 findings of fact. Nothing can be treated as evidence which is
5 not introduced as such. ... Facts and circumstances which
6 ought to be considered must not be excluded. Facts and
7 circumstances must not be considered which should not
8 legally influence the conclusion. Findings based on the
9 evidence must embrace the basic facts which are needed to
10 sustain the order. ...

11 A proceeding of this sort requiring the taking and weighing of
12 evidence, determinations of fact based upon the consideration
13 of the evidence, and the making of an order supported by
14 such findings, has a quality resembling that of a judicial
15 proceeding. Hence it is frequently described as a proceeding
16 of a *quasi judicial* character. The requirement of a "full
17 hearing" has obvious reference to the tradition of judicial
18 proceedings in which evidence is received and weighed by
19 the trier of the facts. The "hearing" is designed to afford the
20 safeguard that the one who decides shall be bound in good
21 conscience to consider the evidence, to be guided by that
22 alone, and to reach his conclusion uninfluenced by extraneous
23 considerations which in other fields might have play in
24 determining purely executive action. The "hearing" is the
25 hearing of evidence and argument.²⁶

26 In *Corbin*, the Arizona Court of Appeals rejected the Commission's argument that
because of the agency's constitutional genesis, the Commission is not subject to
legislative control and judicial scrutiny in setting rates, noting that Article 15, section 6 of
the Arizona Constitution expressly authorizes the legislature to regulate the procedural
aspects of Commission rate proceedings.²⁷ The legislature has exercised this power by
enacting various statutes, codified in Title 40 of the Arizona Revised Statutes, that impose
procedural requirements on the Commission, as well as making the Commission subject
to the requirements of the Arizona Administrative Procedure Act ("APA"), A.R.S. 41-
1001, *et seq.* As such, the Commission's "final decision shall include findings of fact and

²⁶ *Id.* at 224, 693 P.2d at 367, quoting *Morgan v. United States*, 298 U.S. 468 (1936).

²⁷ *Id.*, 143 Ariz. at 224 - 25, 693 P.2d at 367 - 68.

1 conclusions of law, separately stated. Findings of fact, if set forth in statutory language,
2 shall be accompanied by a concise and explicit statement of the underlying facts
3 supporting the findings.”²⁸ “Findings of fact shall be based exclusively on the evidence
4 and on matters officially noticed.”²⁹ “It is not permissible for . . . any administrative
5 body, simply to parrot general statutory requirements or rest on broad conclusory
6 statements.”³⁰ Instead, “findings of fact by the Commission must show which evidence it
7 accepts as competent and worthy of belief, and that which it rejects.”³¹

8 2. Where Does the Economy Fit In?

9 The clear message of *Scates* is that rates are not just and reasonable if they do not
10 produce sufficient revenue to allow for recovery of reasonable operating expenses and a
11 fair rate of return.³² “A utility is entitled to a fair rate of return on the fair value of its
12 property, no more and no less.”³³ “What the company is entitled to ask is a fair return
13 upon the value of that which it employs for the public convenience. On the other hand,
14 what the public is entitled to demand is that no more be exacted from it . . . than the
15 services rendered . . . are reasonably worth.”³⁴ The Commission certainly has a duty to
16

17 ²⁸ A.R.S. § 41-1063.

18 ²⁹ A.R.S. § 41-1061(G).

19 ³⁰ *Rodriguez v. Prince George’s County*, 558 A.2d 742, 748 (Md. App. 1989).

20 ³¹ *Colorado-Ute Elec. Assoc. v. P.U.C.*, 760 P.2d 627, 641 (Colo. 1988). See also *Matter of Water Use*
21 *Permit Applications*, 9 P.3d 409, 475-76 (Haw. 2000) (“where the record demonstrates considerable
22 conflict or uncertainty in the evidence, the agency must articulate its factual analysis with reasonable
23 clarity, giving some reason for discounting the evidence rejected”); *Porter v. South Carolina Pub. Serv.*
24 *Comm’n*, 507 S.E.2d 328, 332 (S.C. 1998) (a “recital of conflicting testimony followed by a general
25 conclusion is patently insufficient”), quoting *Able Communications, Inc. v. South Carolina Pub. Serv.*
26 *Comm’n*, 351 S.E.2d 151, 152 (S.C. 1986).

³² See generally, *Scates*, 118 Ariz. 531, 578 P.2d 612.

³³ *Litchfield Park Service Co. v. Ariz. Corp. Comm’n*, 178 Ariz. 431, 434, 874 P.2d 988, 991 (App. 1994)
(internal quote omitted).

³⁴ *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 149, 294 P.2d 378, 381 (1956) (quoting *State*
of Missouri *ex rel. SW Bell Tele. Co. v. Public Service Comm’n*, 262 U.S. 276 (1923)).

1 protect the public interest, but that duty is based on preventing “excessive and
2 discriminatory rates and inferior service.”³⁵

3 The constitutional basis for Arizona’s fair value ratemaking process is the principle
4 that requiring a utility to provide service without fair compensation is a taking of the
5 company’s property without due process of law.³⁶ Consumers are entitled to protection
6 from excessive rates, but they are never entitled to receive service at rates that fail to
7 provide a reasonable return.³⁷ As the United States Supreme Court has explained, “[r]ates
8 which are not sufficient to yield a reasonable return on the value of the property used at
9 the time it is being used to render the service are unjust, unreasonable and confiscatory,
10 and their enforcement deprives the public utility company of its property in violation of
11 the Fourteenth Amendment.”³⁸

12 Under these basic constitutional principles, the Commission must provide due
13 process and a fair return to utilities in both good and bad economic times. And,
14 unfortunately, the cost to provide utility service does not necessarily go down when the
15 economy is poor. Therefore, it would be unlawful, for example, for the Commission to
16 reduce an otherwise prudent operating expense because economic conditions might make
17 it more difficult for some customers to pay the cost of service. Likewise, the value of a
18 fair value rate base based solely on original cost less depreciation does not change based
19 on current economic conditions.

20 To the extent current economic conditions are relevant to determining a revenue
21 requirement, they are already incorporated in the parties’ cost of capital analysis. The cost
22 of equity is derived by market-based finance models – the Discounted Cash Flow model

23 ³⁵ *SW Gas Corp. v. Ariz. Corp. Comm’n*, 169 Ariz. 279, 286, 818 P.2d 714, 721 (App. 1991) (quoting
24 *Petrolane-Ariz. Gas Serv. v. Ariz. Corp. Comm’n*, 119 Ariz. 257, 259, 580 P.2d 718, 720 (1978)).

25 ³⁶ *Simms*, 80 Ariz. at 149, 294 P.2d at 380 (citing *Smyth v. Ames*, 169 U.S. 466 (1898)).

26 ³⁷ *Scates*, 118 Ariz. at 534, 578 P.2d at 615.

³⁸ *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm’n*, 262 U.S. 679, 690 (1923).

1 and the CAPM – that assume an investor is evaluating the future return on an investment
2 in publicly traded utility stocks. These models rely on current stock prices and other
3 market data for a proxy group of water utilities, the stock of which is traded on major
4 stock exchanges. The Commission has no authority to impose an additional “discount”
5 that is not supported by the testimony, based on assumed difficulties experienced by
6 individual consumers. A utility must be given an opportunity to earn a return that is
7 commensurate with the returns earned by enterprises with comparable risks.³⁹ The failure
8 to do so would violate the comparable earnings standard and, therefore, the utility’s
9 constitutional rights.⁴⁰

10 In questioning the Company’s witness, Chairperson Mayes relied on *Arizona*
11 *Community Action* for the proposition that the Commission must pay close attention to the
12 interests of ratepayers when balancing the interests of shareholders and consumers.⁴¹ That
13 decision, however, does not stand for the proposition that the Commission may lower
14 rates below the cost of service because current economic conditions are unfavorable.
15 *Arizona Community Action* overturned a Commission decision allowing an automatic rate
16 increase if the company’s equity returns fall below a certain threshold.⁴² The court
17 recognized that APS could manipulate equity returns by changing its capital structure, and
18 held that the Commission could not establish an automatic adjustment based solely on a
19 factor that the utility controlled.⁴³ *Arizona Community Action* does not contradict *Scates*,
20 *Simms*, and the many other cases establishing that a fair return is the touchstone for setting
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22 ³⁹ See, e.g., Roger A. Morin, *New Regulatory Finance* 9-12 (Public Utility Reports, Inc. 2006) (“*Morin*”).

23 ⁴⁰ *Bluefield Waterworks*, 262 U.S. at 692 – 93.

24 ⁴¹ Tr. at 48:14-21, referencing *Ariz. Comm’ty Action Ass’n. v. Ariz. Corp. Comm’n*, 123 Ariz. 228, 599
P.2d 184 (1979).

25 ⁴² *Ariz. Comm’ty Action*, 123 Ariz. at 231, 599 P.2d at 187.

26 ⁴³ *Id.*

1 just and reasonable rates. In fact, *Arizona Community Action* expressly recognizes that
2 “[a] utility has the right to assure its investors a reasonable return.”⁴⁴

3 Furthermore, there is no evidence before this Commission in the record of this case
4 that specifies what the current economic conditions are, what impact they are having on
5 LPSCO’s customers, or how such conditions impact the Company’s cost of service,
6 except, of course, for the evidence of expected equity costs used to estimate LPSCO’s cost
7 of capital and the evidence presented by the Company regarding the cost-cutting measures
8 it has implemented.⁴⁵ Given the necessity of making factual findings, there isn’t a record
9 upon which the Commission could make findings about the effect of customer economics,
10 even if it were lawful to lower a utility’s revenue requirement because the country is
11 emerging from recession.

12 Given the stakes in this rate case, LPSCO is forced to respond to the Chair’s
13 requests and statements of law as it has above. LPSCO is not unsympathetic to
14 consumers. The LPSCO-City jointly proposed rate design for the water division
15 recognizes the impact on consumers and moves them “gradually” towards the cost of
16 service.⁴⁶ LPSCO also has proposed a low income tariff for those customers that cannot
17 pay the cost, as opposed to those that just do not want to pay the cost of water utility
18 service. The Company also accepts that to the extent current economic conditions have a
19 place in the ratemaking process, it is in the rate design phase as discussed in the Rate
20 Design section of this brief.

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⁴⁴ *Id.*

25 ⁴⁵ Tr. at 81 – 84.

26 ⁴⁶ *Id.* at 616:2 – 617:24.

1 **II. RATE BASE ISSUES IN DISPUTE**

2 **A. Summary of Rate Base Recommendations**

3 As reflected in their respective Final Schedules, LPSCO's, Staff's and RUCO's
4 proposed rate bases for the water division are as follows:

	<u>OCRB</u>	<u>FVRB</u>
5 Company	\$37,762,676	\$37,762,676
6 Staff	\$37,401,639	\$37,401,639
7 RUCO	\$37,457,973	\$37,457,973

8 For the wastewater division, the rate bases proposed are as follows:
9

	<u>OCRB</u>	<u>FVRB</u>
10 Company	\$28,222,289	\$28,222,289
11 Staff	\$27,746,122	\$27,746,122
12 RUCO	\$23,190,926	\$23,190,926

13
14
15 **B. RUCO's Disallowances From Rate Base for the 2007-2008 Upgrades at**
16 **PVWRF Must Be Rejected.**

17 1. Brief Statement of the Issue In Dispute.

18 In its final schedules, RUCO proposes a reduction of \$3,286,229 from LPSCO's
19 wastewater rate base to remove costs associated with the PVWRF at 50 percent of amount
20 incurred (\$3,500,000) and placed in service during the Test Year, per testimony of
21 Matthew Rowell, and adjust for retirements provided by the Company in Exhibit A-39
22 (\$213,771).⁴⁷ That proposed disallowance pertains to the 2007-2008 Upgrades
23 ("Upgrades") installed at PVWRF during the Test Year. The total cost of those PVWRF
24 Upgrades as installed by LPSCO was \$7,000,000.⁴⁸ RUCO seeks to disallow one-half of

25 ⁴⁷ RUCO Final Schedule 3, page 4 of 4 (wastewater), Adjustment 20.

26 ⁴⁸ Sorensen Dt. at 7; Sorensen Amended Rb. at 17.

1 those Upgrades based *solely* on the testimony of Matt Rowell.⁴⁹ Mr. Rowell testified that
2 “there were significant design problems at the PVWRF” as originally constructed and
3 “correcting these problems necessitated significant upgrades.”⁵⁰

4 To say the least, RUCO’s argument to disallow \$3,500,000 in plant upgrades from
5 LPSCO’s rate base had a chaotic effect on this case. RUCO is the only party to this case
6 proposing such reduction from rate base. Neither Staff nor any other party joined in
7 RUCO’s attempt to confiscate \$3,500,000 in plant additions. RUCO did not present any
8 engineering testimony in support of its disallowance. Instead, RUCO and Mr. Rowell
9 concocted an argument out of thin air that there were design errors at the PVWRF as
10 originally constructed in 2002. Initially, Mr. Rowell interpreted the direct testimony of
11 Mr. Sorensen and a draft report prepared by McBride Engineering Services as indicating
12 there were design errors at the plant.⁵¹ In rebuttal testimony, Mr. Sorensen and
13 Mr. McBride (a civil engineer specializing in design and construction of sewer plants)
14 responded to Mr. Rowell’s conjecture by expressly stating that there were no design errors
15 at PVWRF.⁵² Unfortunately, in his surrebuttal testimony Mr. Rowell continued to claim
16 that the Upgrades were caused by design errors at PVWRF,⁵³ despite the undisputed
17 engineering testimony provided by Mr. McBride. Once again, Mr. McBride responded to
18 Mr. Rowell’s claims in rejoinder testimony.⁵⁴

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22 ⁴⁹ M. Rowell Dt. at 5; M. Rowell Sb. at 13 – 14; Tr. at 825 – 826.

23 ⁵⁰ M. Rowell Dt. at 3 – 4.

24 ⁵¹ M. Rowell Dt. at 5; M. Rowell Sb. at 13 – 14; Tr. at 825 – 826; Ex. A-28 at 14 – 15.

25 ⁵² Sorensen Amended Rb. at 17 – 20; McBride Rb. at 5 – 6.

26 ⁵³ M. Rowell Sb. at 14 – 15.

⁵⁴ McBride Rj. at 1 – 3.

1 Because RUCO would not withdraw Mr. Rowell's testimony, LPSCO took his
2 deposition on November 30, 2009.⁵⁵ Mr. Rowell's deposition testimony unequivocally
3 established that he did not have any basis for recommending a \$3,500,000 reduction in
4 rate base based on design errors in the plant as originally built.⁵⁶ By his own admission,
5 Mr. Rowell is not qualified to render any opinions about the design or engineering of the
6 plant.⁵⁷ Prior to the hearings, LPSCO moved to exclude Mr. Rowell's testimony at trial.⁵⁸
7 The ALJ denied that motion and allowed Mr. Rowell's testimony at trial.

8 In all candor, admission of Mr. Rowell's testimony has made a mockery of the
9 evidentiary hearing process before the Corporation Commission, even with its
10 undoubtedly relaxed standards. To compound matters, Mr. Rowell's unqualified
11 testimony caused a substantial increase in LPSCO's rate case expense and that testimony
12 alone resulted in two additional days of hearing time. It is extremely disconcerting that
13 RUCO's presentation of Mr. Rowell's testimony illustrates the lengths to which RUCO
14 will go to dream up any argument to reduce a utility's rates, including simply making up
15 facts and disregarding undisputed evidence and controlling law.

16 Based on the underlying record and controlling law, the ALJ and Commission
17 should reject RUCO's proposed disallowance for five equally compelling reasons. First
18 and foremost, it is *undisputed* that the PVWRF Upgrades were necessary and prudent,
19 and have been and will continue to be used and useful in the provision of utility service to
20 LPSCO's customers. The record is clear that those Upgrades were installed to address
21 changed conditions and operational challenges at the plant, ultimately leading to better

22 ⁵⁵ Even on that issue, RUCO substantially increased LPSCO's rate case expense by refusing to produce
23 Mr. Rowell for deposition, forcing LPSCO to obtain a subpoena for Mr. Rowell's deposition and then
filing a motion to quash the subpoena. *See Motion to Quash Subpoena* dated November 17, 2008.

24 ⁵⁶ Ex. A-28 at 14 – 16, 20 – 23, 25 – 27, 32 – 40, 42 – 44, 53 – 60, 62 – 67, 87 – 88, 94 – 97.

25 ⁵⁷ *Id.* at 14 – 15.

26 ⁵⁸ *See LPSCO's Motion to Strike Testimony of Matt Rowell* dated December 22, 2009 ("LPSCO's Motion
to Strike").

1 and more cost effective utility service.⁵⁹ That record alone justifies putting the full
2 amount of the Upgrades in rate base.

3 Second, RUCO's proposed disallowance is *not* supported by any evidence in the
4 record. RUCO's disallowance is premised entirely on the supposition and lay person's
5 interpretation that the PVWRF upgrades were caused by design and engineering errors in
6 the original plant. That supposition is false. The evidence is *undisputed* that the PVWRF
7 met any and all design standards as originally constructed. *There isn't a single shred of*
8 *evidence supporting RUCO's arguments that the plant was designed improperly or that*
9 *including the Upgrades in rate base would be unfair to ratepayers.*

10 Third, as a matter of law and fact, Mr. Rowell's testimony should be disregarded in
11 its entirety on this issue. Mr. Rowell is completely unqualified to offer testimony relating
12 to design and engineering issues at the Plant. Fourth, even under RUCO's made up
13 theory, there hasn't been any harm to ratepayers from the Upgrades. RUCO's contention
14 that the timing and magnitude of the PVWRF Upgrades are unusual and unfair to
15 ratepayers is *not* supported by any evidence in the record. Finally, RUCO's proposed
16 disallowance, if adopted, would set a bad and dangerous precedent. Adoption of RUCO's
17 disallowance would have a dramatic chilling effect on utility acquisitions in Arizona and
18 would be nothing short of confiscatory.

19 2. The Commission Should Reject RUCO's Proposed Disallowance.

20 In his argument in defense of soldiers in the Boston massacre in 1770, John Adams
21 noted that "facts are stubborn things; and whatever may be our wishes, our inclinations, or
22 the dictates of our passion, they cannot alter the state of facts and evidence." The
23 Commission should follow that guiding principle with respect to RUCO's proposed
24

25 ⁵⁹ Sorensen Amended Rb. at 20 – 24; McBride Rb. at 4 – 6; McBride Rj. at 2 – 3; Sorensen Rj. at 2 – 4;
26 Tr. at 30 – 32, 119 – 120, 122 – 123, 137 – 141, 154 – 165, 183 – 190, 215 – 220, 225 – 230, 232 – 233,
1278 – 1287, 1308, 1325 – 1329, 1338 – 1340, 1357.

1 disallowance of \$3,500,000 from rate base relating to the PVWRF upgrades. RUCO's
2 attempt to lower sewer rates by any and all means cannot override or alter the undisputed
3 facts, which unequivocally demonstrate that the original plant was designed properly, the
4 Upgrades were necessitated by operational challenges and changed conditions at the plant
5 and within the Company's service territory, and the Upgrades were and are necessary,
6 used and useful in the provision of wastewater service. As such, the ALJ and the
7 Commission should reject RUCO's disallowance.

8 a. As Originally Designed and Constructed, the PVWRF Met All
9 Applicable Design and Engineering Standards.

10 The PVWRF was originally constructed in 2002.⁶⁰ Plant construction was
11 completed just one year prior to the purchase of LPSCO by Liberty Water in 2003.⁶¹ The
12 current plant capacity is 4.1 MGD per day.⁶² The facility possesses an APP limited to 8.2
13 MGD for that site.⁶³ At the time PVWRF was constructed in 2002, land use for the area
14 surrounding the plant was a golf course with commercial zoning.⁶⁴

15 As originally designed and constructed, the plant met all applicable Maricopa
16 County Environmental Services Department, ADEQ and other regulatory standards,
17 regulations and approval. In fact, the plant engineering and construction was reviewed,
18 analyzed and approved by Maricopa County, the City of Goodyear and ADEQ.⁶⁵ The
19 plant was engineered by Pacific Advanced Civil Engineering (PACE), a respected and
20 qualified engineering firm. In October 2001, PACE prepared a Phase I Design Report for
21 the PVWRF. On page 7 of that report, PACE stated:

22 ⁶⁰ Sorensen Dt. at 6.

23 ⁶¹ *Id.*

24 ⁶² *Id.*; McBride Rj. at 3 – 4; Tr. at 231 – 232.

25 ⁶³ Sorensen Dt. at 6; Ex. R-5.

26 ⁶⁴ Sorensen Dt. at 6 – 7; Tr. at 165 – 166.

⁶⁵ Sorensen Amended Rb. at 21; McBride Rb. at 3 – 4; McBride Rj. at 1 – 2; Tr. at 227 – 228.

1 The design and construction of the Palm Valley WRF Phase I
2 will be in conformance with the following codes:

- 3 - MAG – Uniform Details and Standard Specifications
4 for Public Works Construction - 1998
- 5 - City of Goodyear Engineering Standards and Policies
6 Manual
- 7 - ADEQ Engineering Bulletin 11 – 1978
- 8 - Uniform Building Code (UBC) – 1997
- 9 - Uniform Plumbing Code (UPC) – 1997
- 10 - Uniform Fire Code – Latest Edition⁶⁶

11 *The undisputed testimony at trial established that the original plant did not have*
12 *any design errors.* Mr. Sorensen testified that “[t]o my knowledge there were no design
13 flaws or errors for the Palm Valley Water Reclamation Facility. It was designed
14 according to the rules and regulations of the county, of the city at the time it was
15 constructed in 2002.”⁶⁷ Further, Mr. McBride echoed that sentiment by testifying that the
16 original plant was reviewed, inspected and approved by ADEQ, Maricopa County and the
17 City of Goodyear.⁶⁸ Ray Jones (an engineer with more than 20 years of experience
18 operating, constructing and managing utility plants) also testified that “the appropriate
19 regulatory agencies, Department of Environmental Quality and the Maricopa County
20 Environmental Services Department, reviewed [the plant’s] design reports, plans,
21 specifications, issued the appropriate permits, inspected the facilities when they were
22 complete and issued the permits properly for the facility.”⁶⁹

23 Likewise, Staff engineer Marlin Scott determined that the PVWRF Upgrades are
24 used and useful.⁷⁰ Even Mr. Rowell acknowledged that the original plant was reviewed

25 ⁶⁶ Ex. A-34 at 7.

26 ⁶⁷ Tr. at 31.

⁶⁸ *Id.* at 227 – 228.

⁶⁹ *Id.* at 1283.

⁷⁰ Scott Dt. at 1 – 3. *See also* Ex. A-35 at 3.

1 and approved by ADEQ, Maricopa County and the City of Goodyear, including review
2 and approval of the engineering, design and construction.⁷¹

3 b. The PVWRF Upgrades Were Necessitated by Changed
4 Conditions and Operational Challenges at the Plant.

5 LPSCO operated the PVWRF successfully until certain operational challenges
6 arose in 2006-2007.⁷² LPSCO experienced rapid growth from 2003-2007, and the flow
7 capacity at PVWRF increased dramatically during those years.⁷³ As flows to the plant
8 increased and began approaching the design capacity, the plant experienced various
9 operational challenges and increased costs. In turn, LPSCO retained McBride
10 Engineering Solutions to evaluate operational challenges at PVWRF, and to engineer
11 upgrades and improvements.⁷⁴

12 McBride conducted a review of the original designs, process and capacity studies,
13 interviewed LPSCO's operations staff and reviewed the various operational challenges at
14 the plant.⁷⁵ McBride then provided a draft Water Reclamation Facilities Strategic
15 Planning Report to "show target areas where improvements could be made to enhance the
16 overall operation, reliability and costs effectiveness of the plant."⁷⁶

17 In the Evaluation Report, McBride recommended various options for adding
18 additional facilities and processes to the plant to resolve the operational challenges. The
19 2007/2008 Upgrades were improvements to the plant's reliability and redundancy

20 ⁷¹ Tr. at 860 – 861.

21 ⁷² *Id.* at 213 – 216; McBride Rb. at 3 – 4; Ex. R-2 at 4 ("While none of the challenges presented below
22 appear to be preventing the successful operation of the facility, they do show target areas where
improvements could be made to enhance the overall operation, reliability, and cost effectiveness of the
plant.").

23 ⁷³ Sorensen Amended Rb. at 20 – 24; McBride Rb. at 4 – 6; McBride Rj. at 2 – 3; Sorensen Rj. at 2 – 4;
24 Tr. at 221 – 225, 1354 – 1355.

25 ⁷⁴ Sorensen Rb. at 21 – 22; McBride Rb. at 4.

26 ⁷⁵ McBride Rb. at 4; Ex. R-2 at 2 – 4.

⁷⁶ Ex. R-2 at 4.

1 capabilities. Essentially, they were additions to the plant to optimize performance, not
2 repairs or remedies for any design problems.⁷⁷ This type of situation is typical in the
3 utility industry.⁷⁸ In many cases, a wastewater treatment plant will be constructed in
4 accordance with approved engineering plans, but the plant will face operational challenges
5 as the plant is operated at or near full capacity over several years.⁷⁹ Here, rapid growth in
6 LPSCO's service area shortened the time between original construction and the time when
7 sewage flows approached design capacity. In other areas with lower growth rates, the
8 number of years between original plant construction and the arising of "operational
9 challenges" may be longer because flows don't increase as quickly. In either case,
10 however, timing does not lessen the need for plant upgrades when flows near design
11 capacity.

12 At trial, Mr. McBride's testimony was *undisputed* that the PVWRF Upgrades were
13 necessitated by changed conditions that caused operational challenges at the plant.
14 Specifically, Mr. McBride testified that "the upgrades were made in order to address
15 certain operational challenges. The upgrades were intended to increase the reliability and
16 redundancy of the plant, and decrease the operational and crisis management costs."⁸⁰
17 McBride explained those operational challenges as "certain issues that come up that were
18 not apparent in the original, when the plant was operating under lower flows, which will
19 reduce the cost of operating and maintaining the plant."⁸¹ For PVWRF, those operational
20 challenges and changed conditions included "a difference in the peaking factors than were
21

22 ⁷⁷ Sorensen Amended Rb. at 20 – 24; McBride Rb. at 4 – 6; McBride Rj. at 2 – 3; Sorensen Rj. at 2 – 4;
23 Tr. at 30 – 32, 119 – 120, 122 – 123, 137 – 141, 154 – 165, 183 – 190, 215 – 220, 225 – 230, 232 – 233,
1278 – 1287, 1308, 1325 – 1329, 1338 – 1340, 1357.

24 ⁷⁸ McBride Rb. at 5 – 6; Tr. at 195 – 197, 1283 – 1286.

25 ⁷⁹ *Id.*

26 ⁸⁰ Tr. at 138.

⁸¹ *Id.* at 139.

1 anticipated, differences in the fats, oils and grease content, differences in the loading
2 rates” and “any number of unpredictable variables.”⁸²

3 Specifically, Mr. McBride testified that PVWRF had “a higher level of fats, oils
4 and grease in [the] influent than is typical.”⁸³ Those changed conditions led to “a buildup
5 on the influent screen, there was a buildup in the foam with the sequential batch reactors,
6 and that was then passed through towards and causing some clogging problems with their
7 tertiary filters.”⁸⁴ Mr. McBride also stated that the odor control requirements for the plant
8 changed as a result of different zoning requirements around the plant, including a change
9 from a golf course surrounding the plant to in-fill residential development 150 feet from
10 the plant’s fence line.⁸⁵ On June 20, 2007, LPSCO had a 500 gallon spill at the plant due
11 to disc filters being clogged and the failure of the SCADA system to notify operators of
12 high flow levels.⁸⁶ On June 21, 2007, LPSCO had a 25,000 gallon spill due to grease and
13 oil build up in the disc filters at PVWRF.⁸⁷ Those spills were not the result of any design
14 errors.⁸⁸ Instead, as testified by Mr. McBride, the plant needed additional redundancy
15 capabilities and upgrades to improve reliability as PVWRF reached higher flows.⁸⁹

16 c. LPSCO Acted in the Best Interests of Its Ratepayers.

17 Ultimately, Mr. McBride testified that it is standard practice for owners to build a
18 plant based on reasonable design assumptions and at a lower cost, with incremental
19

20 ⁸² *Id.* at 139 – 140.

21 ⁸³ *Id.* at 155 – 156.

22 ⁸⁴ *Id.* at 156.

23 ⁸⁵ *Id.* at 165 – 166.

24 ⁸⁶ Sorensen Dt. at 7. *See also* Ex. A-35 at 3.

25 ⁸⁷ Tr. at 156 – 163.

26 ⁸⁸ *Id.*; McBride Rb. at 3 – 4; Sorensen Amended Rb. at 16 – 21.

⁸⁹ McBride Rb. at 4 – 6; McBride Rj. at 2 – 3; Tr. at 119 – 120, 122 – 123, 137 – 141, 154 – 165, 183 – 190, 215 – 220, 225 – 230, 232 – 233.

1 upgrades made as operational challenges arise.⁹⁰ From a ratepayer standpoint, this makes
2 perfect sense. If the original design assumptions hold true as the plant reaches its design
3 capacity, then additional upgrades would not be necessary. Ratepayers do not suffer any
4 harm and avoid the possibility of paying for unnecessary plant.

5 Here, RUCO argues that LPSCO should have installed the Upgrades in 2002, even
6 though those Upgrades were not necessary at that time. Adoption of RUCO's argument
7 either will cause utilities (and ratepayers) to pay for unnecessary plant at the time of initial
8 construction, or it will discourage utilities from adding plant to address operational
9 challenges and changed conditions. Neither serves the interests of utilities or ratepayers.

10 Mr. McBride testified that, in his professional opinion, PVWRF worked as
11 originally designed and constructed.⁹¹ Even so, the plant faced operational challenges
12 resulting from a variety of changed conditions.⁹² It cannot be stressed enough that the
13 need for upgrades or improvements to a sewer plant often occurs after the plant has been
14 in operation for awhile, which is what happened at PVWRF.⁹³

15 LPSCO responded by spending approximately \$7,000,000 in upgrades to improve
16 PVWRF, including (i) converting an aerobic digestion tank to a third SBR tank for
17 maintenance/redundancy purposes; (ii) converting the anoxic tanks to an equalization
18 basin; (iii) improving influent screening; (iv) adding a surge tank return line; (v) installing
19 additional and better UV disinfection equipment; (vi) adding another dewatering
20 centrifuge; (vii) upgrading and adding electrical service to account for increased loads;
21 and (viii) adding new odor control devices at the plant.⁹⁴ All of the Upgrades were

22 ⁹⁰ *Id.*

23 ⁹¹ Tr. at 214 – 215.

24 ⁹² Sorensen Amended Rb. at 20 – 24; McBride Rb. at 4 – 6; McBride Rj. at 2 – 3; Sorensen Rj. at 2 – 4;
Tr. at 30 – 32, 119 – 120, 122 – 123, 137 – 141, 154 – 165, 183 – 190, 215 – 220, 225 – 230, 232 – 233,
1278 – 1287, 1308, 1325 – 1329, 1338 – 1340, 1357.

25 ⁹³ *Id.*

26 ⁹⁴ Sorensen Dt. at 7 – 8.

1 additions and upgrades to the Plant,⁹⁵ which means customers were not previously
2 charged for those upgrades. In fact, the PVWRF was not put into rate base before this rate
3 case, and customers have not incurred any costs for the Plant.⁹⁶ At hearing, Mr. Bourassa
4 testified that the timing of the upgrades doesn't make any difference for ratemaking
5 purposes, and he also noted that LPSCO "could have put in the \$25 million or more for
6 costs initially and increase their design assumptions to make it a more robust plant. But
7 [LPSCO was] conservative, put in what they thought would be proper to treat the sewage,
8 and then found out after operating for some time that they needed to address certain
9 things."⁹⁷

10 d. The Timing and Magnitude of the PVWRF Upgrades Were
11 Not Unusual or Excessive.

12 The record is clear that between the time that LPSCO was purchased from the prior
13 owner/developer (early 2003) and the time of the odor issue and spills (2006-2007), the
14 load on the system greatly increased due to growth, and residential and commercial
15 development crept much closer to the plant.⁹⁸ In the summer of 2007, the plant had two
16 spill events that confirmed that the plant needed upgrades to optimize the plant and add
17 necessary redundancy and reliability capabilities.⁹⁹ For 2007, the highest average
18 monthly flow was 3.6 MGD in July, which was 87% of the plant's rated capacity.¹⁰⁰ Put

19 _____
20 ⁹⁵ As part of the Upgrades, LPSCO did replace one influent screen and three UV-disinfection units.
LPSCO has retired those items and deducted the retirement costs from rate base. Ex. A-39.

21 ⁹⁶ Sorensen Amended Rb. at 24 – 25. Mr. Bourassa repeated that point at hearing: "The Palm Valley
22 water reclamation facility has never been in rate base. So the company—so it has never been a
consideration in the rates that the customers of LPSCO have paid to date." Tr. at 517.

23 ⁹⁷ *Id.* at 517 – 518.

24 ⁹⁸ Sorensen Amended Rb. at 20 – 24; McBride Rb. at 4 – 6; McBride Rj. at 2 – 3; Sorensen Rj. at 2 – 4;
Tr. at 30 – 32, 119 – 120, 122 – 123, 137 – 141, 154 – 165, 183 – 190, 215 – 220, 225 – 230, 232 – 233,
1278 – 1287, 1308, 1325 – 1329, 1338 – 1340, 1357.

25 ⁹⁹ Ex. A-35 at 3.

26 ¹⁰⁰ *Id.*

1 simply, the necessary odor controls, and reliability and redundancy controls changed after
2 PVWRF had been built.¹⁰¹

3 Perhaps recognizing that Mr. Rowell could not support the position he had taken,
4 RUCO changed its argument in the middle of the evidentiary hearing. Prompted by cross
5 examination of LPSCO's witnesses by Judge Nodes, RUCO changed its focus from
6 design errors to an argument that the timing and magnitude of the PVWRF Upgrades are
7 unusual and unfair to ratepayers. The next day Mr. Rowell added that argument to his
8 trial testimony.¹⁰² This new theory is *not* supported by any evidence in the record.

9 On those issues, Mr. McBride testified that these types of operational challenges
10 are not "unusual because when plants are initially designed, you have to make a lot of
11 assumptions. You make those assumptions based on standards, guidelines, and the best
12 available information you have."¹⁰³ In the case of PVWRF, "the fats, oils and grease
13 levels were higher than anticipated. The loading, organic and total suspended loadings
14 were higher than anticipated. The diurnal curve was not what was anticipated."¹⁰⁴ Once
15 the plant "started operating above 70 percent of its design capacity, assumptions that
16 turned out to be not correct...can cause operational problems in the plant."¹⁰⁵ What's
17 more, the only way to avoid those operational issues when the plant was originally
18 constructed would be to build a plant which would "be three times the cost to build
19 initially."¹⁰⁶

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21 ¹⁰¹ Sorensen Amended Rb. at 20 – 24; McBride Rb. at 4 – 6; McBride Rj. at 2 – 3; Sorensen Rj. at 2 – 4;
22 Tr. at 30 – 32, 119 – 120, 122 – 123, 137 – 141, 154 – 165, 183 – 190, 215 – 220, 225 – 230, 232 – 233,
1278 – 1287, 1308, 1325 – 1329, 1338 – 1340, 1357.

23 ¹⁰² Tr. at 816 – 817.

24 ¹⁰³ *Id.* at 195 – 196.

25 ¹⁰⁴ *Id.* at 196. Diurnal curves are patterns that relate to the changes in loads over the course of a day,
reflecting times when people are using utility services.

26 ¹⁰⁵ *Id.* at 196 – 197.

¹⁰⁶ *Id.*

1 Mr. Jones echoed that sentiment. Mr. Jones specifically refuted RUCO's and
2 Mr. Rowell's claims that "due to the magnitude and nature of those upgrades, that the full
3 cost, it would be inappropriate and unfair to include the full costs of those upgrades in the
4 rate case" of LPSCO.¹⁰⁷ Rather, Mr. Jones testified that it is not "unusual for a
5 wastewater treatment plant to need upgrades shortly or in a relatively short period of time
6 after construction of the plant, particularly in the case of a rapid growth environment."¹⁰⁸
7 After reviewing the engineering testimony, Mr. Jones testified that the Upgrades were not
8 unusual in terms of timing or magnitude, and they were "certainly not of excessive
9 cost."¹⁰⁹ Mr. Jones also testified "that the timing of the upgrades is greatly affected by the
10 growth that the utility is experiencing. The real issue that tends to drive the upgrades is
11 where you are at in terms of capacity relative to the design capacity of the facility. *So in*
12 *the case of a high growth environment where the flows quickly come up to design*
13 *capacities, then it is not unusual to have operational issues, desires to improve*
14 *efficiency that would lead you to make upgrades to the facility.*"¹¹⁰ In fact, Mr. Jones
15 experienced similar issues with respect to additions and upgrades for sewer plants at Sun
16 City West and Anthem.¹¹¹ In both of those cases, the Commission included the upgrades
17 in the utility's rate case.¹¹²

18 Boiled down, the "real issue isn't, in terms of upgrades, usually isn't passage of
19 time so much as a plant approaches its design capacity. That's when it becomes more
20 difficult to operate and when that need for operational enhancements and improvements

21 ¹⁰⁷ *Id.* at 1281.

22 ¹⁰⁸ *Id.* at 1282.

23 ¹⁰⁹ *Id.* at 1283. *See id.* at 1359 ("This facility with the upgrades...is in the \$6 a gallon range. I believe
24 Mr. McBride testified that a typical range could be in the \$9 to \$10 range. I have seen plants 8 to 10
to even \$12 a gallon. And so this is a – the all in price here is a very good cost...").

25 ¹¹⁰ *Id.* at 1284 – 1285 (emphasis added).

26 ¹¹¹ *Id.*

¹¹² *Id.*

1 tend to present themselves.”¹¹³ Mr. Jones testified that “the plant loadings, both BODs,
2 suspended solids, fats, oils and grease, were higher than were expected at the time the
3 design was done.”¹¹⁴ Mr. Jones concluded that “the operational challenges at the plant
4 were as a result of those issues.”¹¹⁵ In turn, Mr. Jones dispelled the notion (suggested by
5 ALJ Nodes) that LPSCO could pursue a claim against PACE-PERC for design or
6 engineering errors at the plant.¹¹⁶ *RUCO did not provide any engineering or other*
7 *testimony in response to Mr. McBride or Mr. Jones.*

8 e. The Upgrades Did Not Cause Any Harm To Ratepayers.

9 The gist of RUCO’s “new theory,” developed on the fly in trial as noted above, is
10 that the timing and magnitude of the Upgrades somehow renders inclusion of the
11 Upgrades in rate base unfair to or unexpected by ratepayers. RUCO only advanced that
12 argument after the ALJ suggested it in cross examination of LPSCO’s witnesses.¹¹⁷

13 As noted above, however, RUCO failed to show that the timing, magnitude or
14 extent of the Upgrades caused any harm to ratepayers. This is true on several fronts.
15 First, the notion that the timing or magnitude of the Upgrades somehow implies design
16 flaws with the plant or resulted in some unknown harm to rate payers is *not* supported by
17 any evidence in this record. Further, adoption of RUCO’s disallowance would mean
18 LPSCO should have built and designed the original PVWRF based on the assumption of
19 the highest levels of influent concentration (loading) which could be encountered.
20 Reducing LPSCO’s rate base for failing to install such Upgrades in 2002 is not supported
21 by any evidence in this record or any ratemaking principles. On the other hand, the

22 ¹¹³ *Id.* at 1326.

23 ¹¹⁴ *Id.* at 1338.

24 ¹¹⁵ *Id.* at 1338 – 1339.

25 ¹¹⁶ *Id.* at 1338 (“I think the designer and contractor delivered a satisfactory facility, and I don’t think that
there would be a basis for a claim against them.”).

26 ¹¹⁷ *Id.* at 816 – 817.

1 evidence is undisputed that the Upgrades were necessary, used and useful, requiring
2 inclusion of the Upgrades in rate base.¹¹⁸

3 Second, RUCO's proposed disallowance runs afoul of industry standards for
4 designing sewer plants. Here, it is clear that the original PVWRF met any and all design
5 and engineering standards. And the plant "worked as designed."¹¹⁹ Excluding any
6 amount of the Upgrades from LPSCO's rate base would amount to a finding that the plant
7 was not properly designed in the first place, which is contrary to the overwhelming
8 engineering evidence presented at hearing. Third, it's undisputed that the Upgrades
9 resulted from changed conditions and operational challenges that arose 4-5 years after
10 original construction. In fact, many of these changed circumstances, i.e. fats, oils and
11 grease concentration and BOD loading, come from the customers themselves. The
12 Commission can't and shouldn't blame LPSCO for such changed circumstances.

13 Fourth, ratepayers did not suffer any harm from the Upgrades for the simple reason
14 that, in terms of cost, the PVWRF "is more on the lower cost side."¹²⁰ RUCO has not
15 produced any evidence of excessive, unnecessary or imprudent costs. Rather, even with
16 the Upgrades, the total cost of the plant (\$24,000,000), was still a low cost:

17 If you combine those two costs, 18 plus six is 24 million for a 4.1 million
18 gallon expandable facility. By expandable I mean it has been done in such a
19 way you do another phase, which costs money to do expansion. If we were
20 to do a plant like that and have the typical assumptions like the assumptions
21 they used to build this plant, it would probably be about \$9 to \$10 a gallon
22 is what I would tell clients to expect for that.¹²¹

23 ¹¹⁸ Ex. A-28 at 27 ("Q. And you would also agree that the 2008 upgrades that were installed by LPSCO
24 are used and useful, correct? A. As far as I can tell, yes.").

25 ¹¹⁹ Tr. at 215.

26 ¹²⁰ *Id.* at 217.

¹²¹ *Id.* at 219 – 220.

1 Fifth, in Decision No. 69165 issued on December 5, 2006, the Commission ordered
2 LPSCO to resolve the odor issues as a condition of approval for the Company's modified
3 Off-Site Facilities Hook-Up Fee Tariff.¹²² In that docket, Staff reviewed the Company's
4 "project involving a series of upgrades to the PVWRF."¹²³ Put simply, the Commission
5 and Staff fully encouraged and supported, if not ordered, the Company's upgrades to the
6 PVWRF to optimize reliability, redundancy and service.¹²⁴ It would be patently unfair for
7 the Commission now to exclude one-half of those costs from LPSCO's rate base.

8 Finally, not only was the ultimate plant constructed for a reasonable and low cost,
9 but installing the Upgrades in 2008 actually saved ratepayers over \$1,000,000 in capital
10 costs on the odor control system, plus additional savings from reduced operational costs
11 on the odor controls.¹²⁵ In 2007, LPSCO addressed the odor issue in two stages. The first
12 stage was to add a Granulated Activated Carbon (GAC) air polishing unit to the plant.
13 The second stage involved adding another GAC unit and upsizing the chemical scrubber
14 on the existing plant, at an anticipated cost of \$1.5 million.¹²⁶ Mr. McBride testified that
15 LPSCO had an estimate for \$1.5 million for a conventional chemical scrubber.¹²⁷

16 Because of those capital costs, LPSCO and McBride commissioned a pilot
17 installation of an Aerisa odor control system that had been used for years in Europe, but
18 was new to the U.S.¹²⁸ The product from Aerisa utilizes oxygen ion clusters to bind with
19 the odor causing agents and neutralize them. The pilot installation was done on a no-risk
20

21 ¹²² *Litchfield Park Service Company*, Decision No. 69165 (December 5, 2006) at 4.

22 ¹²³ Ex. A-35 at 5.

23 ¹²⁴ *Id.*

24 ¹²⁵ Tr. at 219 – 220, 230 – 232.

24 ¹²⁶ *Id.* at 230.

25 ¹²⁷ *Id.*

26 ¹²⁸ *Id.*; Sorensen Dt. at 7 – 8.

1 basis to the Company; if it didn't work, LPSCO didn't pay for it.¹²⁹ The Aerisa system
2 was installed as part of the Upgrades and resolved all of the odor issues at the Plant. The
3 capital cost of the Aerisa system was approximately \$500,000 *or about \$1,000,000 less*
4 *than the estimate for the conventional chemical scrubber.*¹³⁰ Even further, the
5 operational costs of the Aerisa system are about 20% of the costs to operate a
6 conventional chemical scrubber, which means the Aerisa system has saved customers
7 approximately 80% in operational costs for odor controls.¹³¹ That Aerisa system was not
8 available in the United States when the PVWRF was constructed in 2002.¹³²

9 In evaluating any harm to ratepayers, LPSCO's actions in operating and upgrading
10 the PVWRF have served the best interests of ratepayers. The rapidly increased volumes
11 at the plant from 2002-2007 and different influent characteristics at the plant led to the
12 Upgrades. The Plant did not suffer any significant operational challenges until the plant
13 reached 80-85% of its design capacity in 2007. LPSCO then acted in a reasonable,
14 prudent and cost-effective fashion to address those operational challenges by installing the
15 Upgrades in 2007-2008.

16 That is the most prudent course of utility management from a ratepayer standpoint.
17 As RUCO and the Commission have noted in prior cases, capital invested too far in
18 advance of when it is needed is imprudent. The need for the Upgrades did not arise until
19 2006-2007, at which point LPSCO invested the capital and installed the Upgrades.

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24 ¹²⁹ Tr. at 219 – 220, 230 – 232.

25 ¹³⁰ *Id.*

26 ¹³¹ *Id.* at 219 – 220.

¹³² Sorensen Dt. at 7 – 8; Tr. at 219 – 220, 230 – 232.

1 f. The Commission Should Ignore Mr. Rowell's Testimony In
2 Its Entirety On This Issue.

3 RUCO's proposed disallowance is based solely and exclusively on the testimony of
4 Mr. Rowell. Mr. Rowell is an economist proffered by RUCO to offer opinions about
5 alleged design and construction flaws in the PVWRF as originally constructed.
6 Mr. Rowell ultimately concluded that "the costs of the PVWRF upgrades necessitated by
7 the PVWRF's design problems should be shared between the shareholders and the
8 customers," which "results in a disallowance of \$3.5 million of test year plant
9 additions."¹³³ Incredibly, Mr. Rowell did not make that deduction based on any rate
10 making principles or any hard evidence. Instead, Mr. Rowell simply divided "seven
11 million by two."¹³⁴ That's how Mr. Rowell calculated the rate base disallowance.
12 Nothing more, nothing less. Mr. Rowell's rate base disallowance is "not based on any
13 specific numbers, documents or any other information relating to the 2008 upgrades."¹³⁵

14 To say the least, Mr. Rowell is not qualified or competent to offer such opinions as
15 an expert (or lay) witness. All Mr. Rowell did was review the testimony of LPSCO's
16 witness (Greg Sorensen) and a draft engineering report prepared by Mr. McBride and then
17 render his lay interpretations of that testimony and engineering report.¹³⁶ The rebuttal,
18 rejoinder and trial testimony of Mr. Sorensen, Mr. McBride, Mr. Scott and Mr. Jones
19 unequivocally establish that PVWRF did not have any design errors. Mr. Rowell simply
20 does not have any qualifications to offer any contrary opinions.

21 LPSCO understands that Commission proceedings are less formal than Superior
22 Court proceedings, but it bears emphasis that Mr. Rowell's proposed testimony on the

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24 ¹³³ Rowell Dt. at 5.

25 ¹³⁴ Ex. A-28 at 42.

26 ¹³⁵ *Id.* at 66.

¹³⁶ *See* Sorensen Dt. at 7 – 8; M. Rowell Sb. at Ex. 4.

1 design issues wouldn't even be remotely admissible in Superior Court under Arizona
2 statutes pertaining to expert engineering testimony.¹³⁷ Because Mr. Rowell can't meet
3 fundamental standards for reliable and admissible expert testimony, his testimony should
4 be disregarded. Respectfully, his testimony never should have been admitted in the first
5 place.¹³⁸ By his own admission, Mr. Rowell is not qualified to render opinions about
6 design errors:

7 Q. Okay. Mr. Rowell, given that you're not a certified engineer, you're
8 not a licensed contractor and you're not a certified operator, wouldn't
9 you agree with me that you don't have any qualifications to give
10 opinions regarding design errors at the Palm Valley Plant?

11 A. I don't believe I've offered any independent opinions about design
12 errors at the Palm Valley Plant.

13 Q. Okay. What have you offered with respect to design errors at the
14 Palm Valley Plant if you haven't offered independent opinions?

15 A. Regarding the design errors, I've merely taken the opinions
16 expressed by Mr. Sorensen in his testimony.

17 Q. So in other words, all you've done is basically repeat Mr. Sorensen's
18 testimony on what you view as design errors at the plant; agreed?

19 A. That, along with reading the -- I think the MES report on those
20 issues.

21 Q. So in other words, *Mr. Rowell -- and correct me if I'm wrong here -
22 - but essentially what you're saying is that all you've done in your
23 testimony on the design and construction errors is restate
24 Mr. Sorensen's testimony and restate the statements from the
25 McBride Engineering Report; fair?*

26 A. *That's fair.*

Q. *Okay. And you haven't formed any independent opinions of your
own with respect to any design or construction problems at the
plant; agreed?*

A. *That's true, yes.*

Q. *And, in fact, you wouldn't have any qualifications to render any
opinions about design or construction problems at the plant;
agreed?*

A. *Agreed, yes.*

Q. And that's because you're an accountant and not a contractor,
engineer or operator of a wastewater treatment plant; fair?

A. That's fair enough, yes.¹³⁹

¹³⁷ Ariz. Rev. Stat. § 12-2602(B).

¹³⁸ See LPSCO's Motion to Strike.

¹³⁹ Ex. A-28 at 14 - 15 (emphasis added).

1 Aside from his blatant lack of qualification, Mr. Rowell's substantive deposition
2 and trial testimony undercuts the very disallowance he is proposing. For starters,
3 Mr. Rowell agreed that the PVWRF and the Upgrades are "used and useful."¹⁴⁰ Further,
4 Mr. Rowell specifically agreed that ratepayers have "not incurred any additional costs"
5 from the PVWRF Upgrades.¹⁴¹ Mr. Rowell acknowledged "that a utility may discover
6 problems at a plant after it's been operated for several years."¹⁴² Mr. Rowell also
7 admitted that "changed conditions surrounding a sewer plant can necessitate upgrades and
8 modifications to the plant," including changed zoning requirements and increased density
9 of development.¹⁴³ Mr. Rowell acknowledged that LPSCO had no way of knowing
10 PVWRF had any operational problems when Liberty Water acquired LPSCO in 2003.¹⁴⁴

11 Mr. Rowell did not stop there in his deposition. He also testified that had LPSCO
12 installed the Upgrades in 2002 with the original plant, the entire amount of the Upgrades
13 would be included in rate base (minus depreciation).¹⁴⁵ *Obviously, if the entire amount*
14 *of the upgrades would be included in rate base if installed in 2002, then there is no*
15 *justification for excluding those same upgrades from rate base as installed in 2008.*

16 Mr. Rowell's testimony at trial was equally devastating to RUCO's disallowance.
17 To start, Mr. Rowell admitted that the only engineering testimony presented at hearing
18 established "that the 2007 and 2008 upgrades were not the result of any design or
19 engineering errors at the plant."¹⁴⁶ Mr. Rowell conceded that the PVWRF Upgrades were

21 ¹⁴⁰ *Id.* at 27.

22 ¹⁴¹ *Id.* at 43.

23 ¹⁴² *Id.* at 49.

24 ¹⁴³ *Id.* at 95.

24 ¹⁴⁴ *Id.* at 54.

25 ¹⁴⁵ *Id.* at 67, 80.

26 ¹⁴⁶ Tr. at 834.

1 “upgrades” to the plant and not repairs or a rebuild of the plant.¹⁴⁷ Mr. Rowell expressly
2 agreed that LPSCO proved its case relating to the operational challenges at PVWRF.¹⁴⁸

3 With respect to odor controls, Mr. Rowell conceded that the original odor controls
4 at the Plant met all regulatory and design requirements, and that the odor control system
5 was reviewed, inspected and approved by ADEQ, Maricopa County and the City of
6 Goodyear.¹⁴⁹ Mr. Rowell also testified that that the Corporation Commission essentially
7 ordered LPSCO to fix the odor problems at the plant in 2006.¹⁵⁰

8 Put simply, excluding the upgrades from LPSCO’s rate base under these
9 circumstances is nothing more than a confiscatory means for artificially reducing
10 LPSCO’s rate increase. Ultimately, Mr. Rowell’s proposed disallowance is based solely
11 on two things: (1) the “overall magnitude of the upgrades from a cost perspective relative
12 to the original costs” and (2) Mr. Rowell’s “lay reading of descriptions of what actually
13 constituted the upgrades.”¹⁵¹ Adopting a rate base disallowance based on such
14 unsupported and unqualified testimony at trial would violate controlling law, and amount
15 to reversible error.

16
17 g. Adoption of RUCO’s Proposed Disallowance Would Set a
Bad and Dangerous Precedent.

18 As a matter of public policy, RUCO’s disallowance, if adopted, would set a very
19 dangerous precedent. It would tell potential purchasers and existing owners of utilities
20 that any investment made post-acquisition or after original construction to fix the utility or
21 upgrade facilities will have one-half of the value confiscated by the Commission. Buyers
22

23 ¹⁴⁷ *Id.* at 843.

24 ¹⁴⁸ *Id.* at 854.

25 ¹⁴⁹ *Id.* at 860 – 861.

26 ¹⁵⁰ *Id.* at 856.

¹⁵¹ *Id.* at 902.

1 simply won't acquire Arizona utilities under those circumstances. That's not to mention
2 that existing customers would suffer because operational problems would never get
3 addressed or resolved.

4 Even Mr. Rowell acknowledged that "the risk of a possible disallowance would
5 inhibit such investments."¹⁵² He went on to agree that "it's important as a matter of public
6 policy to encourage buyers to acquire smaller water and sewer companies in Arizona."¹⁵³
7 Mr. Rowell acknowledged the importance and public benefits of consolidating smaller
8 water and sewer companies in Arizona.¹⁵⁴ He also agreed that the "more certain a buyer
9 can become that it's going to gain a return on its investment in the plant or upgrades to the
10 existing plant, the more likely that the buyer will acquire the companies."¹⁵⁵

11 Any decision to disallow any portion of the PVWRF Upgrades would set an
12 extremely bad precedent, not to mention constituting an illegal regulatory taking of
13 LPSCO's property. The necessity for optimizing the plant became apparent over time
14 starting around 2006, long after Algonquin purchased LPSCO. Liberty Water buys a lot
15 of assets that are distressed and then pays to bring them up to an adequate level of service.
16 The Commission should be encouraging that type of investment in this state. Liberty
17 Water's acquisition and rescue of the McLain systems is a perfect example.¹⁵⁶ Adoption
18 of RUCO's proposed disallowance in this case would have the exact opposite effect and
19 would strongly discourage investment in Arizona utilities.

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¹⁵² Ex. A-28 at 47.

23 ¹⁵³ *Id.* at 101.

24 ¹⁵⁴ *Id.*

25 ¹⁵⁵ *Id.* at 102.

26 ¹⁵⁶ See *Northern Sunrise Water Company and Southern Sunrise Water Company*, Decision No. 68826
(June 29, 2006).

1 **C. RUCO's Excess Capacity is Imaginary.**

2 In its Final Schedules, RUCO reduces LPSCO's rate base by \$36,500 to "disallow
3 costs of 2004 PACE Report."¹⁵⁷ This disallowance from rate base is premised on the
4 testimony of Mr. Rigsby. Specifically, Mr. Rigsby recommends reducing rate base by
5 \$36,500 relating to a Phase II Design Report prepared by PACE in August 2004.¹⁵⁸
6 Mr. Rigsby's sole justification for this disallowance is that "the Company is attempting to
7 add the costs associated with designing the expansion to rate base."¹⁵⁹ Mr. Rigsby also
8 claims that the Phase II Design Report "is clearly not benefiting current ratepayers"
9 because it relates to a future expansion of the plant.¹⁶⁰

10 RUCO portrays this disallowance as relating to "excess capacity." But the "excess
11 capacity" issue is a red herring because it is *undisputed* that the PVWRF does not have
12 any excess capacity.¹⁶¹ RUCO also suggested that LPSCO already has undertaken and
13 completed the design and engineering for the Phase II expansion of PVWRF.¹⁶² That
14 claim also is a red herring because the evidence, again, is *undisputed* that LPSCO has not
15 undertaken any expansion of PVWRF, let alone designing Phase II for \$36,500.¹⁶³ As
16 such, the fundamental premise of RUCO's disallowance is that any design costs relating
17 to future plant expansions of PVWRF must be excluded from rate base, irrespective of
18 regulatory or permitting requirements.

19 On this issue, LPSCO adequately and fully supported inclusion of \$36,500 in costs
20 for the Phase II Design Report prepared by PACE. Put simply, LPSCO incurred \$36,500

21 _____
¹⁵⁷ See RUCO Final Schedule 3, page 2 of 4 (wastewater), Adjustment 2.

22 ¹⁵⁸ Rigsby Dt. at 4 – 5.

23 ¹⁵⁹ *Id.* at 4.

24 ¹⁶⁰ *Id.* at 5.

25 ¹⁶¹ Ex. A-36; Tr. at 140 ("The capacity of the plant before and after the upgrades is 4.1 gallons a day.").

26 ¹⁶² Rigsby Dt. at 4.

¹⁶³ McBride Rj. at 4; Sorensen Amended Rb. at 13 – 14.

1 in engineering costs for necessary, prudent, used and useful planning and design work
2 relating to PVWRF Phase II.¹⁶⁴ In his testimony, Mr. Sorensen explained that those costs
3 related to “high level analysis of costs of plant expansion from 4.1 mgd to 8.2 mgd.
4 Given that our plant flows are at or near 85 percent of our existing physical capacity, this
5 is reasonable and prudent utility planning required by ADEQ.”¹⁶⁵

6 What’s more, the PVWRF Upgrades required an APP modification including
7 compliance with ADEQ and Maricopa County regulations, which require LPSCO to
8 provide conceptual designs for PVWRF at full build-out.¹⁶⁶ Such conceptual design work
9 was required as a condition of receiving a modified APP for the Upgrades.¹⁶⁷ Mr. Rigsby
10 acknowledged that LPSCO used the Phase II Design Report as the required site facility
11 description in order to obtain the APP amendment for the Upgrades.¹⁶⁸

12 Further, because PVWRF was at over 80% of its rated treatment capacity, ADEQ
13 and Maricopa County guidelines required LPSCO to begin design and planning work for
14 Phase II of PVWRF.¹⁶⁹ As stated by Staff engineer Mr. Scott, “when a plant reaches 80
15 percent of that capacity, they are required to send their plans to Maricopa County or

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17 ¹⁶⁴ Tr. at 55.

18 ¹⁶⁵ Sorensen Amended Rb. at 13 – 14; Ex. A-36.

19 ¹⁶⁶ Tr. at 54 – 55 (“Because under MAG, that site is cited for an 8.2 million gallon facility. And when we
20 filed amended permits for the upgrades in this that are subject to this rate case, there had to be some
21 conceptual design. I will call it high level design, showing the ultimate, you know, buildout. And we had
22 \$36,500 incurred for that type of purpose. And we are talking about a wastewater plant that right now is at
23 roughly 85% of its rated capacity....And my understanding of the County and ADEQ guidelines is that
24 when you are between 80 to 90 percent of your rated capacity you should be in the planning design stages
25 for expansion, and once you hit 90 percent you should be in construction.”).

26 ¹⁶⁷ See A.A.C. R18-9-B202(A)(8) (“A person applying for an individual permit shall submit a design report
signed, dated, and sealed by an Arizona-registered professional engineer.”). By rule, such design report
must include “a site diagram depicting compliance with the setback requirements established in R18-9-
B201(I) for the facility at design flow, and for each phase if the applicant proposes expansion of the
facility in phases.” *Id.* Such design report also must including flow information and data for each phase
of the project. *Id.*

¹⁶⁸ Tr. at 1011 – 1012.

¹⁶⁹ *Id.* at 141.

1 DEQ.”¹⁷⁰ Mr. McBride testified that such requirement is set forth in current guidelines
2 from ADEQ and Maricopa County, and that those guidelines required LPSCO to
3 undertake the type of design work contained in the Phase II Design Report.¹⁷¹ At trial,
4 Mr. Rigsby agreed that LPSCO “should comply with rules, policies and guidelines” of
5 ADEQ and Maricopa County.¹⁷² Compliance with ADEQ and County regulations,
6 policies and guidelines is the textbook definition of reasonable and prudent.

7 Boiled down, the Commission should deny RUCO’s disallowance on this issue
8 because (i) the \$36,500 in design costs relate to prudent utility planning, (ii) such design
9 work was required by ADEQ regulations in order to obtain the APP modification for
10 construction of the 2007-2008 Upgrades, and (iii) LPSCO was required by ADEQ and
11 County guidelines to begin the design and planning process for Phase II of PVWRF once
12 the facility reached 80% of its rated capacity. Those costs are a reflection of prudent and
13 mandatory utility planning. The Commission should support LPSCO’s prudent facility
14 planning and compliance with ADEQ and Maricopa County guidelines, rules and
15 regulations by including that \$36,500 in rate base.

16 **D. RUCO’s Other Plant Adjustments.**

17 In addition to removing over \$3.2 million of used and useful plant from rate base
18 for the reasons discussed above, RUCO proposes at least two dozen additional
19 adjustments to further reduce rate base. For starters, RUCO recommends removal of
20 \$537,000 and \$1.8 million of capitalized affiliate labor from the water and sewer division
21 rate bases, respectively.¹⁷³ RUCO also recommends that an additional roughly \$110,000
22

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24 ¹⁷⁰ *Id.* at 1119.

25 ¹⁷¹ *Id.* at 141.

26 ¹⁷² *Id.* at 1009.

¹⁷³ RUCO Final Schedule 3, pages 2 and 3 of 4 (water) and pages 3 and 4 of 4 (wastewater).

1 of plant be reclassified to unrecoverable expenses.¹⁷⁴ However, RUCO failed to meets its
2 burden of proof on these adjustments.

3 1. Capitalized Affiliate Labor.

4 As discussed in detail below (§ III), Liberty Water provides, among other services,
5 operations, engineering and some construction labor to LPSCO and the other Regulated
6 Utilities.¹⁷⁵ All labor is billed at cost.¹⁷⁶ Supporting documentation provided to Staff and
7 RUCO for all capitalized affiliate labor included in rate base reflected the project name
8 and date, the applicable labor rate, the payroll burden, the total cost, the related affiliate
9 profit and the applicable NARUC account.¹⁷⁷ Notably, however, all affiliate profit was
10 removed from the cost of all services provided by affiliates, following the Commission's
11 decisions in rate cases for LPSCO affiliates BMSC and GCSC.¹⁷⁸ This includes profit on
12 engineering and other labor for capital projects. RUCO witness Sonn Rowell put the
13 profit back in, then she removed over \$2.3 million of used and useful plant from rate
14 base.¹⁷⁹

15 Boiled down, RUCO recommends a \$2.3 million rate base reduction because its
16 witness in this case only "audits invoices."¹⁸⁰ RUCO's witness had "no idea" how any of
17 the subject labor was priced.¹⁸¹ She did not audit the other supporting documentation; she
18 did not even know what information she was given.¹⁸² According to Ms. Rowell, only an
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20 ¹⁷⁴ *Id.*

21 ¹⁷⁵ *E.g.*, Sorensen Amended Rb. at 6:3-11; Tremblay Rj., Ex. GT-RJ1 at 4 – 5.

22 ¹⁷⁶ Tremblay Rj., Ex. GT-RJ1 at 4 – 5.

23 ¹⁷⁷ Bourassa Amended Rb. at 15:1-15; Ex. A-25.

24 ¹⁷⁸ Bourassa Dt. at 7:25 – 8:1; Sorensen Amended Rb. at 3:1-18.

25 ¹⁷⁹ *E.g.*, S. Rowell Dt. at 6:1-19, 12:16 – 13:3.

26 ¹⁸⁰ Tr. at 739:20 – 740:7.

¹⁸¹ *Id.* at 737:15-17.

¹⁸² *Id.* at 739:13-19.

1 invoice can provide the necessary support for a plant item.¹⁸³ Yet Ms. Rowell could offer
2 no authority for her claim that only invoices are relevant.¹⁸⁴ Staff's auditors did not find
3 any lack of support for the \$2.3 million of rate base in this case, and Ms. Rowell could not
4 explain why the same type of supporting documentation satisfied RUCO's analysts (and
5 Staff's) in three prior cases for LPSCO's affiliates, including the concurrently pending
6 BMSC rate case.¹⁸⁵ Obviously, RUCO has fallen well short of sustaining its burden of
7 proof on this substantial adjustment to plant.¹⁸⁶

8 2. The Company Has Been Consistent in Capitalizing and Expensing
9 Plant.

10 “Repairs that extend the life of plant or equipment and/or benefit the Company
11 over more than one year should be capitalized. This is a generally accepted accounting
12 principle.”¹⁸⁷ Mr. Bourassa examined the Company's repair invoices and determined that
13 LPSCO was following this policy on a consistent basis.¹⁸⁸ With minor differences, Staff
14 and LPSCO agreed on the treatment of these costs.¹⁸⁹ RUCO, however, disagreed and
15 removed more than \$110,000 of water and sewer plant from rate base in several separate
16 adjustments.¹⁹⁰

18 ¹⁸³ *Id.* at 740:17 – 741:7.

19 ¹⁸⁴ *Id.* at 741:24 – 742:3.

20 ¹⁸⁵ *Id.* at 741:8 – 742:6.

21 ¹⁸⁶ RUCO may also assert that its adjustments are supported because Ms. Rowell found discrepancies in
22 the amounts of capitalized affiliate profit recorded and removed. *See* S. Rowell Dt. at 20, Table 1. But
23 these discrepancies were minor, and partially explained by Ms. Rowell's own failure to reconcile.
24 Bourassa Amended Rb. at 14:6-21. Such minor discrepancies are well within tolerable limits, and
25 certainly do not support a more than \$2 million reduction to rate base.

26 ¹⁸⁷ Bourassa Amended Rb. at 17:5-7.

¹⁸⁸ *Id.* at 17:3-11.

¹⁸⁹ *Compare* Staff Final Schedules JMM-W7 and JMM-WW7 with Company Final Schedule B-2, page 3.3
(water and wastewater).

¹⁹⁰ RUCO Final Schedule 3, pages 2 and 3 of 4 (water) and pages 3 and 4 of 4 (wastewater).

1 In support of her recommended adjustment, Ms. Rowell sought to rely on excerpts
2 from the NARUC Manual.¹⁹¹ But these excerpts address plant additions and retirements,
3 not when to capitalize or expense repairs.¹⁹² And not all plant improvements lead to
4 retirements.¹⁹³ Moreover, unlike the consistent approach the Company has taken,
5 Ms. Rowell espoused an almost entirely subjective approach to capitalizing or expensing
6 repairs.¹⁹⁴ Apparently, under this subjective standard, the analyst looks at the invoice and
7 if he or she does not find something that says there was a retirement or that the repair
8 extended the useful life, the cost should be expensed.¹⁹⁵ Of course, this is not the
9 province of invoices, as Ms. Rowell admitted.¹⁹⁶

10 Perhaps it simply does come down to who Judge Nodes and then the Commission
11 decides has a “better opinion” on this issue, Ms. Rowell’s or that of Mr. Bourassa’s and
12 Mr. Michlik’s. In making that decision, note should be taken that it is LPSCO that is
13 fulfilling the goal of preventing misuse of capitalization versus expenses by following a
14 consistent policy and practice. This is not a case of the utility trying to “game the system”
15 by capitalizing everything prior to the test year and then expensing everything during the
16 test year. Given the alternative, which is that reasonable costs to repair used and useful
17 plant would simply be forfeited, RUCO’s position should be rejected as unsupported and
18 unnecessarily confiscatory.

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22 ¹⁹¹ Tr. at 720:6 – 721:6.

23 ¹⁹² See Exs. R-20 and R-21.

24 ¹⁹³ Tr. at 810:20-22.

25 ¹⁹⁴ E.g., *Id.* at 755:1-2, 810:15-19.

26 ¹⁹⁵ E.g., *Id.* at 723:10 – 724:7, 732:20 – 733:16.

¹⁹⁶ *Id.* at 724:4-7.

1 **E. Rate Base Issues In Dispute With Staff**

2 1. **Staff's DIT Calculation Is Unsupported By Substantial Evidence.**

3 “Accumulated deferred income taxes (DITs) reflect the timing differences between
4 when income taxes are calculated for ratemaking purposes and the actual federal and state
5 income taxes paid by the Company.”¹⁹⁷ These timing differences occur primarily from
6 differences in depreciation methods. Net DIT liabilities are a deduction to rate base, and
7 net DIT assets are an addition to rate base. SFAS 109 requires the use of deferred tax
8 accounting to recognize these income tax timing differences.¹⁹⁸ In this rate case, the
9 Company and RUCO agree on the DIT methodology, a methodology that is consistent
10 with DIT calculations in other rate cases, and both parties recommend net tax liabilities,
11 deductions from rate base. This is a result of a change in position by RUCO as reflected
12 in its Final Schedules,¹⁹⁹ and the differences in the DIT calculations arise solely from
13 differences in rate base between the two parties. In contrast, Staff seeks to deduct
14 \$335,000 from each division's rate base, almost double the amount calculated by LPSCO
15 or RUCO.²⁰⁰ But Staff's calculation is admittedly flawed.

16 When questioned about his DIT calculation, Mr. Michlik testified that he used data
17 from a year other than the test year, that he failed to reconcile for the differences between
18 the test year and the year he used, and that he failed to adjust for Staff's own plant
19 adjustments.²⁰¹ When offered the chance to correct these flaws in his calculation,
20 Mr. Michlik refused.²⁰² This was unfortunate. DIT calculations are complicated, and

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22 ¹⁹⁷ *Black Mountain Sewer Corporation*, Decision No. 69164 (December 5, 2006) at 12 – 15.

23 ¹⁹⁸ *Id.* at 5:15-20.

24 ¹⁹⁹ Compare RUCO Final Schedule 2, page 4 of 4 (water) and page 3 of 3 (wastewater) with Company
25 Final Schedule B-2, page 5 (water and wastewater).

26 ²⁰⁰ Staff Final Schedules JMM-W10 and JMM-WW10.

²⁰¹ Tr. at 1218:15 – 1219:6, 1222:21-25, 1225:10-24.

²⁰² *Id.* at 1225:25 – 1226:4.

1 subject to update every time rate base changes. In this case, as in others, Mr. Bourassa
2 has explained every step of his calculations in great detail. He has used the same
3 methodology in all cases, a methodology consistent with SFAS 109 and prior Commission
4 decisions.²⁰³ As such, the methodology employed by LPSCO and RUCO in this case to
5 account for DITs as required by SFAS 109 should be adopted.

6 2. “Security” Deposits Should Not Be Deducted From Rate Base.

7 In the direct filing, Mr. Bourassa inadvertently included “security” deposits in the
8 amount of “customer meter” deposits included in rate base.²⁰⁴ While customer meter
9 deposits are included in rate base, security deposits are not a component of rate base,
10 especially in the absence of working capital.²⁰⁵ Accordingly, when the error became
11 known, Mr. Bourassa made an adjustment to remove “security” deposits from the amount
12 of “customer meter” deposits included in rate base.²⁰⁶ RUCO agrees with Mr. Bourassa’s
13 adjustment.²⁰⁷ Staff does not.

14 According to Mr. Michlik, all customer deposits must be included in rate base.²⁰⁸
15 According to Staff’s witness, NARUC and a Matthew Bender Publication supported this
16 adjustment.²⁰⁹ However, these documents were not disclosed as part of Staff’s work
17 papers, they were not cited in Staff’s prefiled testimony, and Mr. Michlik admitted that he
18 found at least one of the documents after he had made his recommended adjustment.²¹⁰

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20 ²⁰³ Bourassa Amended Rb. at 9 – 11, 22 – 23; Bourassa Rj. at 9 – 11 and 20.

21 ²⁰⁴ Bourassa Amended Rb. at 12:19-22.

22 ²⁰⁵ *Id.* at 12:22-25.

23 ²⁰⁶ *Id.* at 12:16-22.

24 ²⁰⁷ S. Rowell Sb. at 4:10-13. *See also* RUCO Final Schedule 2, page 1 of 4 (water) and 1 of 3
(wastewater).

25 ²⁰⁸ Michlik Water Dt. at 10:8-11.

26 ²⁰⁹ Tr. at 1154:13 – 1155:17.

²¹⁰ *Id.* at 1213:7 – 1214:3.

1 Moreover, Mr. Michlik did not even follow the documents he allegedly relied upon. Staff
2 ignored the requirement that interest be accounted for if “security” deposits are to be
3 included in rate base.²¹¹ Even in its Final Schedules, where Staff included the test year
4 interest paid on the deposits in operating expenses, Staff failed to account for the amount
5 of developer deposits included in the amount of security deposits, and Staff failed to offset
6 the Accounts Receivable balances associated with the security deposits included in rate
7 base.²¹²

8 As Mr. Michlik admitted, unlike “meter” deposits, “security” deposits secure
9 payment of an amount owed to the utility.²¹³ If, as Mr. Michlik testified, “security”
10 deposits should be a deduction from rate base because the Company has the use of the
11 funds in support of rate base,²¹⁴ then the funds that those deposits are securing, which
12 LPSCO does not have the use of, must also be taken into account. Staff’s adjustment to
13 deduct security deposits from rate base failed to take any of these things into account;
14 therefore, Staff failed to meet its burden of proof on this issue.

15 3. Recovery of the Deferred Regulatory Asset Is in the Public Interest.

16 In Decision No. 69912 (September 27, 2007), the Commission issued LPSCO an
17 Accounting Order. Specifically, the Company was authorized to defer all costs incurred
18 responding to the potential contamination of its water supply by TCE from a nearby
19 Superfund site.²¹⁵ Although no ratemaking treatment was guaranteed, the Accounting
20 Order gave LPSCO the opportunity to seek to recover costs, even if they were incurred
21 outside of a test year.²¹⁶

22 ²¹¹ *Id.* at 1156:25 – 1159:2.

23 ²¹² *Id.* at 1238:25 – 1239:11.

24 ²¹³ *Id.* at 1238:22-24.

25 ²¹⁴ Michlik Water Sb. at 5:20-25.

26 ²¹⁵ Ex. A-8.

²¹⁶ *Id.* at 6:19-23; Sorensen Rj at 12:8-15.

1 Between the effective date of the Accounting Order, July 1, 2006, and the end of
2 the test year, September 30, 2008, LPSCO incurred \$82,561 in testing and legal fees
3 related to the threat of groundwater contamination. The Company proposes to recover
4 these costs by amortizing the amount over 10 years.²¹⁷ These amounts were reasonably
5 and prudently incurred to monitor the proximity of the contamination to its water supplies
6 and to protect its right to seek redress in the event the plume impacts its wells.²¹⁸

7 RUCO agrees that these amounts are reasonable and should be recovered through
8 rates.²¹⁹ However, RUCO has made an adjustment to reduce the amount of the regulatory
9 asset by 10 percent believing somehow this amount, equating to one-year of recovery,
10 would otherwise be “double-counted.”²²⁰ Ms. Rowell was unable to explain how an
11 amount that had never been previously recovered could be double-counted, except that the
12 manner in which Ms. Rowell accounted for the recovery of the regulatory asset appears to
13 be anomalous.²²¹ Ms. Rowell further admitted that the Commission had not previously
14 approved her amortization methodology.²²² Most importantly, the manner in which the
15 Company proposes to recover the deferred regulatory asset does not result in any double
16 counting or double recovery.²²³

17 Staff agrees with LPSCO and RUCO that the amounts incurred by the Company
18 were reasonable and incurred to enhance ratepayer safety.²²⁴ Nevertheless, Staff believes
19 that recovery is premature because it is unknown whether the contamination will reach the

20 ²¹⁷ Company Final Schedules B-2, page 2 and C-1, page 1 (water); Bourassa Dt. at Schedule C-2, page 13
21 (water).

22 ²¹⁸ Sorensen Amended Rb. at 11:18 – 12:15.

23 ²¹⁹ Tr. at 748:17-21.

24 ²²⁰ S. Rowell Dt. at 5:18-21.

25 ²²¹ Tr. at 749:5-10.

26 ²²² *Id.* at 752:2-5.

²²³ Bourassa Amended Rb. at 18:7-22.

²²⁴ Michlik Water Sb. at 6:17-21.

1 Company's wells or whether any of the costs the Company has incurred will be
2 recovered.²²⁵ But these unknowns are not LPSCO's fault, nor are they within LPSCO's
3 control. Furthermore, it is not known if the contamination will ever reach the Company's
4 water supplies, nor is it not known whether LPSCO will be able to recover any of the
5 reasonable costs it is incurring from a third-party.²²⁶ Indeed, all that is known is that
6 LPSCO is acting reasonably to protect its customers' safety, in accordance with the
7 Commission-issued Accounting Order. In this light, denial of the cost recovery in this
8 case will simply send the message that the costs should not continue to be incurred.²²⁷
9 That would not be in the public interest, as LPSCO cannot be expected to incur costs that
10 it is not being allowed to recover even if they are intended to enhance customer safety.

11 **III. INCOME STATEMENT ISSUES IN DISPUTE**

12 **A. The Central Cost Allocation**

13 Perhaps the most maddening issue in dispute between LPSCO and Staff/RUCO
14 relates to LPSCO's Central Office Cost allocation. Both Staff and RUCO are intent on
15 opposing LPSCO's affiliate cost allocations from APT, irrespective of the undisputed
16 evidence that LPSCO provides high quality utility service at a reasonable cost.²²⁸

17 Staff and RUCO disallow virtually the entire Central Office Cost pool based on
18 their belief that the services provided by and costs incurred by APT do not benefit LPSCO
19 or its ratepayers.²²⁹ Staff premises its disallowance on three fundamental arguments, all
20 based primarily on the notion that the APT costs do not benefit LPSCO or its ratepayers:

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22 ²²⁵ *Id.* at 7:12-14.

23 ²²⁶ Sorensen Rj. at 12:16 – 13:2.

24 ²²⁷ Sorensen Amended Rb. at 13:5-13; Tr. at 1226:14 – 1227:4.

25 ²²⁸ Sorensen Amended Rb. at 7 – 10; Tremblay Rj. at 2 – 4, 8 – 27, Ex. GT-RJ1; Bourassa Dt. at 15, 43;
Bourassa Amended Rb. at 33 – 38, 42 – 45; Tr. at 421, 440 – 455, 466 – 470, 472 – 473, 490 – 499.

26 ²²⁹ Michlik Wastewater Dt. at 15 – 16; Michlik Water Dt. at 16 – 17; M. Rowell Dt. at 12 – 13.

- 1 (1) "The costs of a regulated utility, such as LPSCO, should only include those
2 costs that would have been incurred on a 'stand-alone basis.'"²³⁰
- 3 (2) Based upon review of the actual supporting invoices provided by the
4 Company, Staff determined that almost all of the costs were obviously
5 attributable to the operations of the APIF or one of its affiliates, therefore,
6 Staff assigned 90 percent of the costs to APIF. The remaining ten percent
7 recognizes that the other affiliates receive a benefit from the common costs,
8 and therefore, should be allocated a percentage greater than zero."²³¹
- 9 (3) "Since shareholders seek a profit and the APIF incurs expenses (e.g. central
10 office costs) in order to generate that profit, it is obvious that central office
11 costs are incurred primarily for the benefit of the shareholders rather than
12 for LPSCO as the Company indicates. The central office costs would have
13 been incurred even if the Fund did not own LPSCO because the central
14 office costs were incurred to make a profit for the shareholders and not to
15 operate LPSCO. The benefit to LPSCO is only incidental."²³²

16 RUCO disallowed the majority of the APT costs because LPSCO's "explanations were
17 insufficient and did not establish that the services provided by Algonquin Power Trust are
18 necessary for the provision of water and wastewater service."²³³

19 Staff's and RUCO's approach to the cost allocation issue is fundamentally flawed.
20 Read closely, the testimony of Mr. Michlik and Mr. Rowell does nothing more than state
21 their beliefs or generic opinions that the APT costs do not benefit ratepayers. But more
22 than just *any* evidence is required to support Staff or RUCO's disallowance. "Substantial
23 evidence is evidence which would permit a reasonable person to reach the trial court's
24 result."²³⁴ Thus, a Commission decision must be "rationally based on evidence of
25 substance."²³⁵ "Mere speculation and arbitrary conclusions are not substantial evidence
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²³⁰ Michlik Wastewater Dt. at 15; Michlik Water Dt. at 16 – 17.

²³¹ Michlik Wastewater Dt. at 16; Michlik Water Dt. at 17 – 18.

²³² Michlik Wastewater Dt. at 16; Michlik Water Dt. at 18.

²³³ M. Rowell Dt. at 16.

²³⁴ *Estate of Pousner*, 193 Ariz. 574, 579, 975 P. 2d 704, 709 (1999). See also *Denise R. v. Ariz. Dep't of Economic Security*, 2009 WL 1451452 (Ariz. App. 2009).

²³⁵ *Tucson Elec. Power v. Ariz. Corp. Comm'n*, 132 Ariz. 240, 245, 645 P.3d 231, 237 (1982).

1 and cannot be determinative.”²³⁶ Staff and RUCO do not meet the substantial evidence
2 test for their Central Office Cost disallowances.

3 Staff and RUCO also apply the wrong ratemaking standard by failing to recognize
4 that the APT costs are necessary for LPSCO to provide utility services *under the APIF*
5 *business model*.²³⁷ Put another way, Staff and RUCO must evaluate the corporate
6 allocations *within APIF’s business model*, which Staff and RUCO have not done.²³⁸
7 “Public utilities must be given the opportunity to prove the necessity and reasonableness
8 of any expenditure challenged by a commission (or intervenor). To justify expenditure, a
9 company must show that the expense was actually incurred (or will be incurred in the near
10 future), that the expense was necessary *in the proper conduct of its business or was of*
11 *direct benefit to the utility’s ratepayers*, and that the amount of the expenditure was
12 reasonable.”²³⁹ Here, Staff has applied the “direct benefit” to ratepayers prong to the
13 exclusion of other prongs which can be used to justify an expense, namely that “the
14 expense was necessary in the proper conduct of [LPSCO’s] business.”²⁴⁰ The
15 Commission should not evaluate LPSCO’s cost allocations based on a different business
16 structure (i.e., stand alone) than LPSCO currently operates under.

17 With respect to the APT costs, LPSCO has shown that the contractual services
18 expenses were actually incurred by APT/LPSCO, that those costs are reasonable and that
19 the APT costs are necessary expenses under the APIF business model, which allows
20 LPSCO to provide quality utility service at a low cost. The evidence presented by
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23 ²³⁶ *City of Tucson v. Citizens Utils. Water Co*, 17 Ariz. App. 477, 481, 498 P.2d 551, 555 (1972).

24 ²³⁷ Sorensen Amended Rb. at 7 – 10; Tremblay Rj. at 3 – 5; Tr. at 440 – 441, 443 – 444, 470 – 472, 496.

25 ²³⁸ Sorensen Amended Rb. at 4 – 6; Tr. at 920 – 926, 931, 1181 – 1183, 1207 – 1209.

26 ²³⁹ The Regulation of Public Utilities, C. Phillips (1993) at p. 258 (emphasis added).

²⁴⁰ *Id.*

1 Mr. Sorensen, Mr. Bourassa and Mr. Tremblay on these issues demonstrates the necessity
2 and benefits of the APT Central Office Cost allocations.²⁴¹

3 The importance of this Central Office Cost issue can't be understated. Staff's
4 disallowance of 99% of APT's affiliate costs is a clear rejection of the APIF/APT/Liberty
5 Water business model. If that corporate service model is rejected by the Commission,
6 then Liberty Water will have no choice but to operate LPSCO and the other Arizona
7 utilities differently, which most certainly will increase operating costs.²⁴² APIF and its
8 other regulated utilities and unregulated businesses aren't going to subsidize 99 percent of
9 an over \$1 million allocation pool for the benefit of the Arizona utilities.²⁴³ When APT
10 withdraws the various corporate services from LPSCO, the Commission, Staff and RUCO
11 shouldn't be surprised when the quality of services provided by LPSCO declines,²⁴⁴ or
12 LPSCO's operating expenses increase and the Company comes back to the Commission
13 to ask for a rate increase based on "stand-alone" costs. This doesn't seem like the proper
14 message to be sending to utilities or consumers.

15 Frankly, it's hard to understand why Staff and RUCO oppose a shared services
16 model that is designed to deliver high quality utility service at a reasonable price.²⁴⁵
17 That's especially puzzling given numerous failed utility operations in Arizona.²⁴⁶ The

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19 ²⁴¹ Sorensen Amended Rb. at 7 – 10; Bourassa Dt. at 15, 43; Bourassa Amended Rb. at 33 – 38, 42 – 45;
Tremblay Rj. at 2 – 4, 8 – 27, Ex. GT-RJ1; Tr. at 421, 440 – 441, 443 – 455, 469 – 473, 496 – 498.

20 ²⁴² Tremblay Rj. at 26 – 27; Tr. at 1212.

21 ²⁴³ Tremblay Rj. at 26 – 27.

22 ²⁴⁴ *Id.*

23 ²⁴⁵ Tremblay Rj., Ex. GT-RJ1 at 4 ("The fundamental principle of this Cost Allocation Methodology is that
LPSCO and the other Regulated Utilities should be charged for all costs incurred by affiliates—both
Liberty Water and APT—so that the Regulated Utilities can provide a high level of safe and reliable water
and wastewater utility service to customers."); Sorensen Amended Rb. at 3 – 10.

24 ²⁴⁶ See Ex. A-13 at 11 ("Currently, Far West states that its wastewater system does not meet regulatory
requirements and as a result its ability to maintain safe and reliable sewer service is in doubt."); *Id.* at 26
("Given the Company's high leverage and ongoing disputes with ADEQ, it would appear to be an unlikely
candidate to receive additional debt or equity capital."). See also Decision No. 68826.

1 notion, as Staff and RUCO suggest, that these allocated costs from APT do not benefit the
2 ratepayers is undercut by the very high level of service LPSCO is providing to customers
3 at a reasonable cost, a fact which neither Staff nor RUCO contest.²⁴⁷

4 One of the more frustrating aspects of Staff's position on LPSCO's corporate cost
5 allocations is that Staff does not apply any published or established cost allocation
6 principles, standards or rules to LPSCO.²⁴⁸ Boiled down, Staff simply presumes that the
7 APT cost allocations are disallowed unless LPSCO meets its "burden to demonstrate that
8 the costs allocated down from APT are comparable to stand-alone utilities," which
9 Mr. Michlik acknowledged is a standard that was not formally adopted by Staff or known
10 to LPSCO prior to filing of this rate case.²⁴⁹ Careful review of Mr. Michlik's testimony
11 demonstrates that Staff has not provided any supporting evidence for its arguments.
12 Instead, Staff simply says that LPSCO has failed to prove its case or that LPSCO has not
13 shown that the APT costs would have been incurred by a stand-alone Arizona utility, a
14 standard that Mr. Michlik himself has not used to evaluate LPSCO's cost allocations.²⁵⁰

15 Staff has the burden of proof to support its proposed disallowances. As a matter of
16 law, it's improper for Staff or RUCO to presume that the APT costs are improper without
17 supporting evidence. In a prior decision, this Commission found that affiliate cost
18 allocations "must be closely scrutinized in a general rate case" but that "such heightened
19 degree of scrutiny *may not amount to a presumptive disallowance of all costs incurred*

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22 ²⁴⁷ See Comparison of LPSCO's Operating Costs to Other Arizona Water Utilities and Comparison of
23 LPSCO's Operating Costs to Other Arizona Sewer Companies (attached as **Brief Exhibit 1**); Ex. A-11;
Sorensen Amended Rb. at 4 – 10; Sorensen Dt. at 6 – 10.

24 ²⁴⁸ Tr. at 1176 – 1778, 1199 – 1200.

25 ²⁴⁹ Sorensen Amended Rb. at 3 – 5; Tr. at 1182 – 1184.

26 ²⁵⁰ Tr. at 1182 – 1183. Mr. Michlik admitted that he "didn't do that analysis." *Id.* at 1183. Mr. Rowell
also did not apply this purported standalone standard to LPSCO or compare LPSCO's operating costs to
any standalone utilities. *Id.* at 920, 926.

1 *as a result of transactions with affiliates...*²⁵¹ The Commission also found that affiliate
2 costs are not presumptively allowed, *which means that LPSCO's allocations must be*
3 *judged based on the evidence presented at hearing.*²⁵²

4 1. The APT Cost Allocation Issues In Dispute.

5 The only cost allocation issues in dispute relate to Central Office Costs allocated
6 from APT to LPSCO. Staff and RUCO do not dispute the affiliate cost allocations from
7 AWS d/b/a Liberty Water to LPSCO.²⁵³ Even so, the amount in dispute on the Central
8 Office Cost allocations is significant. In LPSCO's Final Schedules, the total Central
9 Office Cost pool is \$5,125,785.²⁵⁴ For LPSCO's water and wastewater divisions, 73.02%
10 of that Central Office Cost pool is allocated to APIF's Energy Group (46 facilities) and
11 26.98% is allocated to Liberty Water's Utility Infrastructure Group (17 utilities, including
12 LPSCO).²⁵⁵ Under that method, \$1,331,385 of the pool is allocated to the 17 utilities
13 owned and operated by APIF.²⁵⁶ In turn, 23.32% of those costs are allocated to LPSCO's
14 water division, which equals \$310,479.²⁵⁷ For LPSCO's wastewater division, 25.83% of
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16 ²⁵¹*Arizona Public Service Company*, Decision No. 55931, 91 P.U.R. 4th 337, 350 (April 1, 1988)
17 (emphasis added). Mr. Sorensen echoed that standard in his hearing testimony. Tr. at 95 – 96, 312 – 313.
18 See also Sorensen Amended Rb. at 3 – 4 (“As I answered Judge Nodes in the recent BMSC rate case
19 hearing, we expect scrutiny of all of our expenses and investments, and even heightened scrutiny of our
20 affiliate transactions. As the last BMSC rate case ordered, our affiliate transactions should be scrutinized
21 to ensure there are no “potential abuses.” But such scrutiny is not the same as a presumption that we are
22 doing something wrong, nor does scrutiny preclude Staff from recognizing the improvements that we have
23 already made... Scrutiny also does not mean that the costs, which represent services provided to the utility
24 that are needed and/or that enhance the utility's operations, financial stability and health, or financial
25 integrity, should be stricken from the Company's operating expenses.”); Tr. at 95 (Mr. Sorensen testified
26 that “just because it is an affiliated transaction or related party transaction doesn't make it bad, wrong or
objectionable.”).

²⁵² See Decision No. 55931, 91 P.U.R. 4th at 350.

²⁵³ Tr. at 913 – 914, 1167.

²⁵⁴ Company Final Schedule C-2, page 13 (water) and page 12 (wastewater).

²⁵⁵ Company Final Schedule C-2 at 13 (water).

²⁵⁶ *Id.*

²⁵⁷ *Id.*

1 those costs are allocated to LPSCO's water division, which equals \$343,688.²⁵⁸ The total
2 Central Office Costs allocated to LPSCO is \$654,167.

3 In its Final Schedules, Staff disallows \$4,702,400 of the Central Office Cost pool
4 (91.7%).²⁵⁹ For both LPSCO's water and wastewater divisions, Staff allowed a total of
5 \$228,557 in Central Office Costs.²⁶⁰ Staff then allocates 1.41% of that cost pool, which
6 equals \$3,219.11, each to LPSCO's water and wastewater divisions, resulting in a total
7 Central Office Cost allocation of \$6,483.22.²⁶¹ All told, Staff disallows 99% of the APT
8 Central Office Cost pool. In its final schedules, RUCO disallows \$186,950 in Central
9 Office Costs for the wastewater division and RUCO disallows \$286,799 for the water
10 division.²⁶² RUCO's final schedules result in a total Central Cost allocation of
11 \$180,419.²⁶³

12 2. The APIF Corporate Business Model and Structure.

13 LPSCO is one of seven Arizona utilities owned by the Algonquin Power Income
14 Fund ("APIF").²⁶⁴ The other Arizona utilities include Black Mountain Sewer
15 Corporation, Gold Canyon Sewer Company, Rio Rico Utilities, Bella Vista Water
16 Company, Northern Sunrise Water Company, and Southern Sunrise Water Company.²⁶⁵
17 Those regulated utilities are wholly-owned subsidiaries of Liberty Water Company
18 ("LWC").²⁶⁶ LWC, in turn, is owned by Algonquin Power Income Fund ("APIF").

19
20 ²⁵⁸ Company Final Schedule C-2, page 12 (wastewater).

21 ²⁵⁹ Staff Final Schedules JMM-W18 at 1 and JMM-WW15 at 1.

22 ²⁶⁰ *Id.*

23 ²⁶¹ *Id.*

24 ²⁶² RUCO Final Schedules 4b (water) and 4c (wastewater).

25 ²⁶³ *Id.*

26 ²⁶⁴ Tremblay Rj. at 3 – 4, Ex. GT-RJ1 at 4.

²⁶⁵ *Id.*

²⁶⁶ *Id.*

1 APIF's primary business is ownership of generating and infrastructure facilities
2 through investments in securities of subsidiaries.²⁶⁷ APIF owns 46 electric facilities and
3 17 water and wastewater facilities in Canada and the United States.²⁶⁸ APIF also has an
4 operating interest in eight other facilities, but does not own them.²⁶⁹ APIF is publicly
5 traded on the Toronto Stock Exchange (TSX).²⁷⁰ Like publicly traded companies in the
6 United States, APIF is subject to various public reporting, financial, audit and other rules
7 and requirements of the TSX.²⁷¹ For our purposes, APIF's compliance with those rules
8 requires the various services provided by APT as a condition of LPSCO's use of capital
9 from APIF/APT and LPSCO's use of APT's services provided under the APIF
10 umbrella.²⁷²

11 a. The Role of Liberty Water.

12 LPSCO is operated by Algonquin Water Services d/b/a Liberty Water ("Liberty
13 Water"), along with six other regulated Arizona water and sewer utilities, and eleven
14 regulated water and sewer providers in Texas, Missouri and Illinois.²⁷³ Liberty Water
15 provides all day-to-day administration and operations personnel for LPSCO.²⁷⁴

16 _____
17 ²⁶⁷ Tremblay Rj. at 3.

18 ²⁶⁸ *Id.*

19 ²⁶⁹ *Id.*

20 ²⁷⁰ *Id.* at 3 – 4. *See also id.*, Ex. GT-RJ1 at 4. The Toronto Stock Exchange is the largest stock exchange
21 in Canada, the third largest in North America and the eighth largest in the world by market capitalization.

22 ²⁷¹ The rules of the Toronto Stock Exchange ("TSX") are available at the following website:
23 http://tmx.complinet.com/en/display/display_main.html?rbid=2072&element_id=103. The ALJ may take
24 judicial notice of these rules. For example, § 404 of the TSX's General Requirements for Maintaining a
25 Listing on the exchange provides that "to maintain its listing a company must make public disclosures and
26 keep the Exchange fully informed of both routine and unusual events and decisions affecting its security
holders."). Likewise, the TSX rules require APIF to maintain and provide annual and quarterly financial
statements, and to undergo necessary financial audits. *See* TSX Rules, Part IV, §§ 443-454. The ultimate
purpose of the TSX rules is strong corporate governance.

²⁷² Tremblay Rj. at 4, 10 – 11, 16 – 20; Tr. at 470 – 472, 496 – 498.

²⁷³ Tremblay Rj. at 4 – 5.

²⁷⁴ *Id.* at 5; Sorensen Amended Rb. at 4 – 10.

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b. The Role of APT.

APT provides financial, strategic management, compliance, administrative and support services to the regulated utilities operated by Liberty Water, as well as to the unregulated utility assets owned by APIF.²⁷⁵ The head office of APT is located in Oakville, Ontario, Canada and provides administrative, technical and management support, regulatory compliance, and oversight of strategic direction, including approvals of budgets and ensuring a strict level of corporate governance for LPSCO and all of the utilities operated by Liberty Water.²⁷⁶ One fundamental misconception that Staff has relating to APT is Staff's belief that the services provided by APT to LPSCO generate profit or revenue for APIF or its investors.²⁷⁷ That simply isn't true. As testified by Mr. Tremblay, APT exists solely for the benefit of the utilities and other facilities APIF owns. APT does not have any business operations, other than to provide administrative services to the facilities owned by APIF.²⁷⁸ If those utilities and other facilities did not exist, APT and all of these indirect corporate administrative costs would not exist.²⁷⁹

Put another way, the costs incurred by APT do not generate revenue or income for APIF because those costs are provided solely for the benefit of APIF's facilities, including LPSCO.²⁸⁰ Allocation of those costs simply allows APIF to recover those necessary operating costs from the utilities, like LPSCO, that use and benefit from the APT services.

²⁷⁵ Tremblay Rj. at 8 – 10.
²⁷⁶ *Id.* at 8 – 9. During discovery, Staff expressed concerns and reservations about the locations of the corporate headquarters of APT/APIF in Canada. LPSCO would hope that Staff and the Commission based would not unfairly discriminate against Canadian ownership. Further, any such prejudice makes little sense because there isn't any difference between a corporate office located in Canada and a corporate headquarters located in Deer Valley, Arizona (Global Water) or California (Chaparral City Water Company).
²⁷⁷ Michlik Wastewater Sb. at 7 – 8; Michlik Water Sb. at 8 – 9; Tr. at 496 – 498.
²⁷⁸ Tremblay Rj. at 13 – 14; Tr. at 496.
²⁷⁹ *Id.*
²⁸⁰ Tremblay Rj. at 13 – 15; Tr. at 498.

1 Staff's claims to the contrary are wrong and unfounded. To illustrate this point, let's say
2 APT pays KPMG \$100,000 for audit services relating to all 63 facilities owned by APIF.
3 In turn, 26.98% of that cost is allocated to the 17 regulated utilities (\$26,980) with 23.32%
4 then allocated to LPSCO's water division, or \$6,291.77. Allocating that \$6,291.17 to
5 LPSCO doesn't generate additional revenue for APIF; rather, such allocation pays for
6 LPSCO's portion of the audit costs paid by APT. Recovery of the costs of doing business
7 under APIF's business model is not generation of shareholder revenue. Even Staff's
8 claims that costs related to shareholder communications generate revenue are incorrect.
9 Funds received from shareholders of APIF aren't revenue; those funds are capital
10 investment or equity. Those funds are then invested by APIF into the 63 owned facilities,
11 including LPSCO. That is not revenue, it's the cost of obtaining investment equity.

12 3. Liberty Water's Shared Services Minimizes Costs for LPSCO and the
13 Other Regulated Utilities.

14 In Decision No. 55931, this Commission specifically found that "the allocation of
15 general corporate expenses among affiliates represents a pooling and sharing of expenses
16 to minimize costs, not the sale of services to maximize revenues."²⁸¹ That's exactly how
17 Liberty Water's shared service model and corporate cost allocation methodology works.
18 The affiliate cost allocations from APT to LPSCO do not generate or maximize revenue
19 for APIF. Rather, they are recovery of necessary costs under a shared service model
20 designed to share costs and minimize operating expenses.²⁸²

21 a. The Liberty Water Cost Allocations.

22 LPSCO does not operate as a stand-alone utility.²⁸³ LPSCO is operated by Liberty
23 Water, along with six other regulated Arizona water and sewer utilities, and eleven

24 ²⁸¹ Decision No. 55931, 91 P.U.R. 4th at 348.

25 ²⁸² Tremblay Rj. at 4 – 6, 13 – 15; Tr. at 421 – 422.

26 ²⁸³ Tremblay Rj. at 4 – 5.

1 regulated water and sewer providers located in Texas, Missouri and Illinois.²⁸⁴ Liberty
2 Water provides all of the day-to-day administration and operations personnel for these
3 regulated utilities.²⁸⁵ All operations and engineering labor is charged by Liberty Water
4 directly to LPSCO and the other separate regulated entities operated by Liberty Water.²⁸⁶
5 Liberty Water charges those labor rates at cost.²⁸⁷ Engineering technical labor, which is
6 capitalized, is charged on the same basis, plus an allocation for Liberty Water's corporate
7 overheads such as rent, materials/supplies, etc.²⁸⁸

8 Labor for accounting, billing and customer service, human resources, health and
9 safety, cannot be allocated using timesheets due to the nature of the costs. It simply is not
10 practical or feasible to keep track of time for employees that serve multiple utilities in
11 small time increments during the course of a work-day.²⁸⁹ A shared call center is the
12 perfect example: a customer service representative at Liberty Water's call center will field
13 calls from customers of LPSCO, Gold Canyon, Black Mountain, Bella Vista Water
14 Company in southern Arizona and the three other states. This work directly benefits all of
15 the regulated utilities, so the costs need to be allocated to all of them. These costs are
16 allocated based on the relative customer counts of all of the regulated utilities under the
17 Liberty Water umbrella.²⁹⁰

18 Overhead costs, like rent, insurance, administration costs, depreciation of office
19 furniture and computers, also cannot be directly attributed to specific utilities.²⁹¹ As such,

20 ²⁸⁴ *Id.*

21 ²⁸⁵ *Id.*

22 ²⁸⁶ *Id.*; Sorensen Amended Rb. at 4 – 10.

23 ²⁸⁷ Tremblay Rj. at 5 – 6; Sorensen Amended Rb. at 2 – 3; Bourassa Dt. at 15, 43.

24 ²⁸⁸ Tremblay Rj. at 5 – 6.

25 ²⁸⁹ *Id.* at 6 – 7.

26 ²⁹⁰ *Id.* at 7 – 8; Sorensen Amended Rb. at 4 – 6; Bourassa Dt. at 15, 43; Bourassa Amended Rb. at 33 – 38,
42 – 45.

²⁹¹ *Id.*

1 these costs are allocated to LPSCO by use of a “four factor” methodology that considers
2 relative size through four weighted four factors – total plant, total customers, expenses
3 and labor.²⁹² This type of four-factor methodology has been utilized with Commission
4 approval by other Arizona utilities, including Chaparral City Water Company and Global
5 Water.²⁹³ All of the costs charged by Liberty Water to LPSCO are based on actual costs,
6 either directly charged or through the four factor allocations described above.²⁹⁴ ***Staff and***
7 ***RUCO do not oppose these cost allocations from Liberty Water to LPSCO.***

8 b. The APT Central Office Cost Allocations.

9 At trial, Mr. Tremblay presented a detailed paper entitled “Liberty Water Affiliate
10 Cost Allocation Methodology,” which is attached to his rejoinder testimony as Exhibit
11 GT-RJ1. That paper explains in detail all of the affiliate cost allocations to the Regulated
12 Utilities by Liberty Water and APT. That paper also demonstrates the substantial benefits
13 that LPSCO and its customers receive from the services provided by APT.²⁹⁵ ***Staff and***
14 ***RUCO did not provide any substantial evidence to refute Mr. Tremblay.***

15 APT’s executive management and administrative support includes accounting and
16 finance, human resources, employee benefits, regulatory and information systems
17 services.²⁹⁶ The services provided by APT are necessary to allow LPSCO and other
18 regulated utilities to have access to capital markets for capital projects and operations, and
19 are necessary to allow LPSCO to provide a high level of service at the lowest cost.²⁹⁷

20 _____
21 ²⁹² *Id.*

22 ²⁹³ See Direct Testimony of Marvin E. Millsap, filed October 3, 2008 in Docket No. W-02113A-07-0551,
23 at 29. See also Direct Testimony of Gregory Butler filed February 20, 2009 in Docket Nos. SW-03575A-
24 09-0077 and SW-20445A-09-0877, at 10 – 14. Global Water used a modified four factor methodology in
25 its current rate case.

24 ²⁹⁴ Tremblay Rj. at 2 – 3.

25 ²⁹⁵ *Id.* at Ex. GT-RJ1.

26 ²⁹⁶ *Id.* at 8 – 9, Ex. GT-RJ1 at 7 – 13.

²⁹⁷ *Id.*

1 All of the APT costs are indirect costs.²⁹⁸ These costs include professional services
2 like third-party legal, accounting, tax, and auditing that are done for the benefit of
3 LPSCO.²⁹⁹ These costs include costs for licenses, fees and permits, IT, Payroll, and HRIS
4 maintenance contracts, as well as the rent and depreciation of office furniture and
5 equipment and computers in the central office.³⁰⁰

6 These costs are allocated to LPSCO, and each of the other utilities, facilities and
7 plants owned and operated by APIF. The allocation is made in two parts. To start, there
8 are 63 total entities owned and operated by APIF, 17 of which are the regulated utilities
9 operated by Liberty Water.³⁰¹ In turn, 17 divided by 63 is 26.98%, which means 26.98%
10 of the total Central Office Cost pool is allocated to Liberty Water.³⁰² The second phase of
11 the allocation is that Liberty Water allocates the costs between LPSCO and the 16 other
12 regulated utilities based on customer counts.³⁰³ The reason these costs are allocated under
13 this formula is that they aren't capable of being directly charged to the 63 facilities.³⁰⁴

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16 ²⁹⁸ *Id.*

17 ²⁹⁹ Tremblay Rj. at 8 – 12, Ex. GT-RJ1 at 7 – 13.

18 ³⁰⁰ *Id.*

19 ³⁰¹ *Id.* at 8 – 9, Ex. GT-RJ1 at 7 – 10; Tr. at 99 – 100, 455 – 456.

20 ³⁰² *Id.* Amazingly, LPSCO and Staff can't even agree on the number of facilities actually owned by
21 LPSCO. Staff locates 1.41% of its allowable APT costs to LPSCO based on a Staff's claim that APIF
22 owns 71 facilities, not 63 (1/71 equals 1.41%). Michlik Wastewater Dt. at 16 – 17; M. Rowell Sb. at 11.
23 Frankly, it's hard to believe Staff or RUCO can make that argument with a straight face because of the
24 undisputed record. APIF only owns and operates 63 facilities, not 71. Tr. at 460 – 473; Tremblay Rj. at 3.
25 Staff's confusion apparently stems from the fact that APIF owns the debt of seven companies. *Id.* Those
26 7 facilities are simply operated by APIF and do not generate costs that are included in the APT cost pool.
The eighth facility is a land field gas facility that has not been operational for years. Tr. at 461. It's
undisputed that APT does not incur any central office costs or provide capital investment for those eight
facilities. *Id.*; Tremblay Rj. at 16. Thus, Staff and RUCO allocate Central Office Costs to eight facilities
that do not use those services, which artificially decreases the cost allocations to those entities actually
using the APT services.

³⁰³ Tremblay Rj. at 6 – 7, Ex. GT-RJ1 at 6 – 12.

³⁰⁴ *Id.*

1 As presented at hearing, APIF considered other allocation cost drivers, including
2 revenues, plant and operating costs.³⁰⁵ Using those drivers, the allocation percentages for
3 the initial phase of the allocation to the 17 regulated utilities were 17.02% (revenue),
4 28.87% (operating costs) and 29.74% for plant.³⁰⁶ When weighted equally, the result is an
5 allocation of 24.96% to the 17 regulated utilities.³⁰⁷ Liberty Water's use of facility counts
6 as the initial allocation methodology complies with the NARUC Guidelines on Cost
7 Allocations and Affiliate Transactions and results in a reasonable allocation of necessary
8 costs to LPSCO.³⁰⁸ Even so, if the Commission feels that use of a blended allocation
9 methodology, such as the one shown on Exhibit A-12, is preferable, LPSCO would
10 consider adopting such blended methodology.³⁰⁹

11 4. The Success of the APIF Shared Services Model, Including the APT
12 Services, Is Demonstrated by the Fact That LPSCO's Total Operating
13 Expenses Compare Favorably to Other Arizona Water and Sewer
14 Utilities.

15 The Liberty Water shared services model works as one integrated whole. The
16 success of this model is demonstrated in comparisons of LPSCO's operating costs with
17 the operating costs of various comparably sized Arizona water and wastewater utilities.
18 At hearing, Mr. Michlik suggested that LPSCO "could probably look at maybe Arizona

19 ³⁰⁵ Tr. at 413 – 416, 456 – 460; Ex. A-12.

20 ³⁰⁶ *Id.*

21 ³⁰⁷ Ex. A-12 at 2.

22 ³⁰⁸ Bourassa Amended Rb. at 36, 44.

23 ³⁰⁹ Tr. at 103. It also should be noted that revenue alone to allocation corporate costs is not a proper
24 methodology because the purpose of cost allocations is to appropriately apportion costs where they are
25 incurred. Revenue does not reflect how or to what extent various facilities use the services provided by
26 APT. In short, revenue is not directly comparable between the utilities and power generation businesses.
For example, in 2008, the utilities division accounted for 29% of the total controllable operating costs of
APIF while only producing 17% of the revenue, which shows that greater levels of input (expenses) are
required to drive revenues for the regulated utilities as compared to the electric facilities. Allocating based
on revenue alone is not consistent with the purpose of the allocations. For clarity, a Central Office Cost
allocation to LPSCO based solely on revenue would result in approximately \$320,000 in APT costs
allocated to LPSCO. *Id.* at 922 – 923.

1 Water, Arizona-American..." as comparisons to LPSCO.³¹⁰ ALJ Nodes also made a
2 similar suggestion.³¹¹ Ironically, Mr. Michlik suggested that comparison, but Staff didn't
3 bother to undertake any such comparative analysis, particularly when Staff has better
4 access to this information than any other party to this case.³¹²

5 In response to those suggestions at hearing, LPSCO prepared the charts attached as
6 **Brief Exhibit 1**, which compare LPSCO's operating costs to the operating costs of other
7 Arizona water and sewer companies.³¹³ For the water division, the charts compare
8 LPSCO's operating costs to the operating costs of ten other comparably size water
9 companies, including seven stand-alone utilities or divisions³¹⁴ and three utilities under
10 affiliate holding company structures.³¹⁵ The charts also compare the operating costs of
11 LPSCO's wastewater division to the operating costs of seven other Arizona sewer
12 companies, including three stand-alone utilities and four affiliate owned utilities.³¹⁶

13 On a per customer basis, LPSCO's water division ranks 2nd lowest in terms of
14 operating costs per customer, which means LPSCO's operating costs per customer are the

15 ³¹⁰ *Id.* at 1185.

16 ³¹¹ *Id.* at 1190.

17 ³¹² *Id.* at 1183 – 1184. It also should be mentioned that LPSCO does not agree that such comparative
18 analysis is appropriate. Rather, each Utility's operating costs should be evaluated under the particular
19 circumstances of each company's rate case, not in comparison to other utilities. LPSCO is providing the
attached charts solely in response to claims and arguments made by the ALJ, Staff and RUCO at the
hearing.

20 ³¹³ The information contained on the attached charts is based on each Company's Adjusted Test Year
21 figures contained in each utility's Schedule C-1 Income State and each Utility's H-2 Schedule in each
22 company's recent rate case filed with the Commission. All of the information contained on the charts is
publicly available and publicly filed information. A list of the docket numbers for each company's rate
case also is attached as **Brief Exhibit 1**.

23 ³¹⁴ Johnson Utilities, Arizona Water Co. (Eastern Group), H2O, Inc., Arizona Water Co. (Western Group),
Arizona Water Co. (Casa Grande) and Arizona Water Co. (Northern Group) are stand-alone utilities.

24 ³¹⁵ Arizona-American (Anthem Water), Chaparral City Water Company, and Global Water—Santa Cruz
Water Co. are operated under an affiliate holding company structure.

25 ³¹⁶ Far West, Coronado Utilities and Johnson Utilities are stand-alone utilities; Arizona-American
26 (Anthem-Agua Fria), Arizona-American (Anthem), Arizona-American (Mohave) and Global Water-Palo
Verde Utilities are operated under affiliate holding company structures.

1 second lowest out of 11 companies.³¹⁷ For LPSCO's wastewater division, the chart shows
2 that LPSCO's operating costs, on a per customer basis, rank third lowest (6th out of 8) in
3 terms of operating costs per customer.³¹⁸ For both divisions, LPSCO's operating costs per
4 customer rank below the average cost per customer of the entire comparable group.³¹⁹

5 These charts confirm the testimony provided by LPSCO in this case relating to
6 Liberty Water's shared services model—namely, that the APT business model allows
7 LPSCO to provide high quality utility service at a low cost.³²⁰ Put simply, Liberty
8 Water's shared services model works and provides substantial benefits to LPSCO and its
9 customers. Staff's presumption that the APT cost allocations artificially inflate LPSCO's
10 costs and expenses above industry norms simply isn't true.³²¹

11 At hearing Mr. Tremblay provided further evidence that the APT corporate costs
12 are prudent, reasonable and under control.³²² In Exhibit A-10, Mr. Tremblay compared
13 the costs under Liberty Water's shared services model to the costs LPSCO would need to
14 incur for a finance department on a stand-alone basis.³²³ On that specific issue, under
15 Liberty Water's shared services model, the "savings per year are just over \$71,000."³²⁴

16 ***Staff and RUCO did not provide any contrary evidence.***

17 Mr. Tremblay also demonstrated that the APT costs are "under control" and
18 comparatively lower than other public traded utilities.³²⁵ In Exhibit A-11, Mr. Tremblay

19
20 ³¹⁷ See **Brief Exhibit 1** (comparison to other Arizona water utilities).

21 ³¹⁸ See **Brief Exhibit 1** (comparison to other Arizona sewer companies).

22 ³¹⁹ **Brief Exhibit 1.**

23 ³²⁰ Sorensen Amended Rb. at 7 – 10; Tremblay Rj. at 2 – 4, 8 – 27, Ex. GT-RJ1.

24 ³²¹ Michlik Wastewater Dt. at 14; Michlik Water Dt. at 15.

25 ³²² Tr. at 424 – 431; Ex. A-10; Ex. A-11; Ex. A-12.

26 ³²³ Tr. at 424 – 429; Ex. A-10.

³²⁴ Tr. at 425.

³²⁵ *Id.* at 434 – 435; Ex. A-11.

1 compared LPSCO's allocations from APT to the costs of the public traded utilities used in
2 Staff's cost of capital sample group.³²⁶ Those utilities are Connecticut Water, San Jose
3 Water, American States, Aqua America, California Water and Middlesex Water, all
4 publicly traded.³²⁷ Mr. Tremblay compared LPSCO's costs per customer for director fees,
5 audit fees, tax fees and management/CEO fees for LPSCO to the same costs for the
6 sample group utilities.³²⁸ As testified by Mr. Tremblay, "[u]sing this comparison,
7 [LPSCO] is lower in almost every, almost every publicly traded company in the sample"
8 group.³²⁹ *Staff and RUCO did not refute that evidence at hearing either.*

9 5. The APT Corporate Costs Allocated to LPSCO Are Reasonable,
10 Necessary and Beneficial to Ratepayers by Allowing LPSCO to
11 Continue Providing a High Level of Utility Service at a Low Cost.

12 On the APT costs, Staff's fundamental premise for disallowing those costs is that
13 the APT costs "primarily benefit" APIF and its investors, and only provide "peripheral"
14 benefits to LPSCO.³³⁰ Mr. Michlik does not explain exactly how he made that
15 determination, and he does not provide any evidence in support of that argument. In
16 disallowing the APT cost, Staff relies heavily, if not exclusively, on a stand-alone
17 comparison as a requirement for approval of cost allocations, even though there is no
18 authority for any such standard.³³¹ Neither Staff nor the Commission has formally
19 adopted that standard as the defining standard for corporate cost allocations, let alone
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21 _____
22 ³²⁶ *Id.*

23 ³²⁷ Tr. at 423 – 424, 434 – 435; Ex. A-11.

24 ³²⁸ *Id.*

25 ³²⁹ Tr. at 437.

26 ³³⁰ Michlik Wastewater Dt. at 15 – 16; Michlik Water Dt. at 16 – 17; M. Rowell Dt. at 12 – 13; Tr. at 1181 – 1182.

³³¹ Tr. at 1183 – 1184.

1 prior to the filing of this case or the start of LPSCO's test year.³³² Staff has not even
2 applied or investigated its own standard with respect to the APT allocations.³³³

3 Staff's slapdash attempt to use that standard retroactively to disallow the APT costs
4 is patently unfair and a violation of LPSCO's due process rights.³³⁴ Even worse, in using
5 that standard, Staff presumes that stand-alone utilities provide the same level and security
6 of service as provided under APIF's business model. That simply isn't true, as
7 demonstrated by service and financial problems experienced by various stand-alone
8 utilities including Far West and the McLain utilities.³³⁵

9 By contrast, the underlying record shows that the APT costs are reasonable,
10 necessary and beneficial to ratepayers by allowing LPSCO to provide high quality utility
11 service. Generally, the services provided by and costs incurred by APT fall into four
12 categories: (1) Strategic Management, which includes management fees, general legal
13 services and other professional services; (2) Capital Access, which includes
14 licenses/fees/permits, unit holder communications and escrow fees; (3) Financial
15 Controls, which include audit services, tax services and trustee fees; and
16 (4) Administrative/Overhead Costs.³³⁶ Each of these categories of APT costs, in turn,
17 provides substantial benefits through access to capital and strong corporate governance.³³⁷

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20 ³³² *Id.*

21 ³³³ *Id.*

22 ³³⁴ See, e.g., *State v. Thompson*, 204 Ariz. 471, 65 P.3d 420 (2003)(stating that "laws must provide explicit
23 standards for those charged with enforcing them..."); *Giaccio v. Pennsylvania*, 382 U.S. 399 (1966)
24 (stating that "a law fails to meet the requirements of the Due Process Clause if it is so vague and
standardless that it leaves ... judges and jurors free to decide, without any legally fixed standards, what is
prohibited and what is not in each particular case").

25 ³³⁵ See Ex. A-13; Decision No. 68826, *et. seq.*

26 ³³⁶ Tremblay Rj. at 8 – 12, Ex. GT-RJ1.

³³⁷ *Id.*

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a. Strategic Management.

Strategic management decisions are critical for any utility. The need for strategic management is even more pronounced for LPSCO as a regulated utility that depends on access to capital for operational and capital needs.³³⁸ These services are necessary for LPSCO to provide service and obtain capital financing under the APIF business model.

These services include legal expenses incurred by APT for general legal matters pertaining to all facilities owned by APIF also are included. These legal services are required in order for APIF to provide capital funding to individual utilities, without which the utilities could not provide adequate service.³³⁹ These legal services involve matters not specific to a single facility, including review of audited financial statements, annual information filings, Sedar filings (mandatory filings for companies listed on the Toronto Stock Exchange, similar to EDGAR filings for the SEC in the United States), review of contracts with credit facilities, incorporation, tax issues, market compliance, and other similar legal costs.³⁴⁰ General legal services are one of the foundations for proper corporate governance. These legal services are a prerequisite for LPSCO's continued access to capital markets available to APIF.³⁴¹ At hearing, Mr. Rowell conceded that LPSCO benefits from strategic management for utility services.³⁴²

The Strategic Management Costs also involve professional services, including strategic plan reviews, capital market advisory services, ERP System maintenance, benefits consulting, and other similar professional services.³⁴³ The Strategic Management

³³⁸ Tremblay Rj. at 8 – 12, Ex. GT-RJ1; Tr. at 417 – 420.
³³⁹ Tremblay Rj. at 8 – 10, Ex. GT-RJ1 at 10.
³⁴⁰ *Id.*
³⁴¹ *Id.*
³⁴² Tr. at 925.
³⁴³ Tremblay Rj. at 8 – 10, Ex. GT-RJ1 at 8 – 17.

1 Costs incorporate management fees paid to APT for strategic management of all APIF
2 facilities.³⁴⁴ These fees provide for the financial and capital funding services necessary
3 for the regulated utilities, including LPSCO, to fund utility operations.³⁴⁵ Management
4 Fees are charged to APT as a monthly fee which is then allocated to the utilities division
5 (26.98%), and then to each individual utility based on customer count.³⁴⁶ Ratepayers
6 avoid the burdens of senior management staff at each utility by sharing of resources
7 between all utilities, resulting in significant savings.

8 These management services also allow LPSCO to have an available source of
9 capital funding in the provision of utility services at a cost cheaper than what such utilities
10 could obtain on their own.³⁴⁷ APT management services are required in the provision of
11 service by LPSCO because the managers oversee utility operations, provide capital and
12 operating budgets, and provide strategic planning services. They also develop overall
13 corporate strategies such as long term financial planning and capital needs, negotiate
14 contracts, allocate capital among utilities and approve high level expenditures.³⁴⁸
15 Ultimately, LPSCO receives the benefit of having its own highly functioning executive
16 management team at a fraction of the cost of having its own executive management.

17 b. Access to Capital Markets.

18 One of APT's primary functions is to ensure that APIF's facilities have access to
19 quality capital. In order for LPSCO to have continued access to capital markets, APT
20 incurs a variety of costs for the benefit of the utilities, including LPSCO.³⁴⁹ On this issue,
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22 ³⁴⁴ Tremblay Rj. at 23 – 25, Ex. GT-RJ1 at 9 – 10.

23 ³⁴⁵ *Id.*

24 ³⁴⁶ *Id.* at Ex. GT-RJ1; Tr. at 9 – 10.

25 ³⁴⁷ Tremblay Rj. at 23 – 25, Ex. GT-RJ1 at 9 – 10.

26 ³⁴⁸ *Id.*

³⁴⁹ Tremblay Rj. at 8 – 10, 23 – 28, Ex. GT-RJ1; Tr. at 931, 940 – 945, 947 – 950.

1 Mr. Rowell agreed that LPSCO “benefit(s) from the equity” capital provided by APT.³⁵⁰
2 And Mr. Michlik made the same concession by noting that it “is probably good for
3 companies to have access to equity” capital.³⁵¹ Mr. Michlik also agreed that funding from
4 the TSX is LPSCO’s only source of equity capital.³⁵²

5 To start, APT incurs license costs and fees to ensure that APIF can participate in
6 the Toronto Stock Exchange.³⁵³ These licensing and permit fees are required in order to
7 sell units on the Toronto Stock Exchange. The benefit of these costs is undisputed –
8 LPSCO has access to capital only so long as APIF is able to access capital markets.³⁵⁴

9 The source of LPSCO’s capital funding is investors who buy units in APIF. Those
10 unit holders invest in APIF, and, in turn, provide capital funding to the regulated
11 utilities.³⁵⁵ In making those investments, unit holders expect monthly distributions on the
12 units they own. Escrow Fees to pay investor dividends are incurred in order to ensure that
13 unit holders of APIF continue to maintain ownership, and that new shareholders are
14 enticed to invest in the Fund.³⁵⁶ These types of costs are not any different than finance
15 charges, interest payments or other charges incurred by utilities through debt financing.³⁵⁷

16 Similarly, unit holder communication costs are incurred by APT to comply with
17 the filing and regulatory requirements of the Toronto Stock Exchange.³⁵⁸ These costs
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19 ³⁵⁰ Tr. at 924. See also *id.* at 940.

20 ³⁵¹ *Id.* at 1197.

21 ³⁵² *Id.* at 1204.

22 ³⁵³ Tremblay Rj., Ex. GT-RJ1 at 11 – 12.

23 ³⁵⁴ *Id.* at 24 – 27.

24 ³⁵⁵ *Id.* at 24 – 25, Ex. GT-RJ1; Tr. at 11 – 12.

25 ³⁵⁶ Tremblay Rj. at 24 – 25, Ex. GT-RJ1; Tr. at 443 – 444.

26 ³⁵⁷ For example, Far West Water & Sewer Company incurred \$1,300,000 in fees and costs to obtain IDA bonds to financing various capital improvement projects, plus additional charges for bond reserve and ongoing debt service. See Ex. A-13 at 8.

³⁵⁸ Tremblay Rj. at 24 – 25, Ex. GT-RJ1; Tr. at 440 – 441.

1 include news releases, unit holder conference calls and other similar costs. These
2 disclosures are required by law to ensure a level of integrity and rigor is applied to the
3 management of the regulated utilities.³⁵⁹ It can't be stressed enough that in the absence of
4 unit holder communication costs, investors would not invest in the units of APIF, and
5 APIF wouldn't have capital to invest in LPSCO.³⁶⁰ Mr. Rowell testified that
6 "communicating with the investors is something the APIF needs to do" and "publicly
7 traded companies are required to provide, you know, communications with their
8 investors."³⁶¹

9 On this record, it's undisputed that the services provided by APT are necessary to
10 allow LPSCO and the other regulated utilities to have access to capital markets for capital
11 projects and operations. *Both Mr. Michlik and Mr. Rowell conceded at trial that access*
12 *to capital from the TSX is beneficial to LPSCO.*³⁶² In today's market place, the
13 importance of ready access to capital can't be understated. Many stand alone Arizona
14 utilities simply do not have the steady access to capital that is available to LPSCO under
15 the APIF corporate model. Far West Water & Sewer Company is a perfect example.³⁶³
16 Staff's and RUCO's denial of the APT costs may result in withdrawal of equity capital to
17 LPSCO, which ultimately could result in a highly leveraged utility. LPSCO's only source
18 of equity capital is from sale of units in APIF on the Toronto Stock Exchange.³⁶⁴

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22 ³⁵⁹ *Id.*

23 ³⁶⁰ *Id.*

24 ³⁶¹ Tr. at 950.

25 ³⁶² *Id.* at 470 – 472, 924, 1197.

26 ³⁶³ Ex. A-13 at 26 ("Given the Company's high leverage and ongoing disputes with ADEQ, it would appear to an unlikely candidate to receive additional debt or equity capital.").

³⁶⁴ Tremblay Rj. at 9 – 11, 16 – 20, Ex. GT-RJ1 at 12 – 14; Tr. at 1204.

1 c. Financial Controls and Corporate Governance.

2 Financial Control costs incurred by APT are another integrated piece of corporate
3 governance. Financial controls and corporate governance services provided by APT
4 benefit LPSCO and its ratepayers by ensuring that situations like Far West or the McLain
5 systems don't happen. Any company that wishes to raise capital at a decent rate must
6 prove proper corporate governance. Less governance means more risk and a higher cost
7 of capital. The financial control services provided by APT are critical and necessary to
8 LPSCO's ongoing viability.³⁶⁵ Put another way, absent those services provided by APT,
9 LPSCO would be forced to operate as a stand-alone utility with higher costs and operating
10 expenses. Operating as a stand alone utility also raises the very real possibility of
11 declining quality of service.³⁶⁶ LPSCO is a healthy utility largely because of the financial
12 controls and corporate governance services provided by APT.³⁶⁷

13 Under financial controls, APT incurs costs for tax services to ensure prudent tax
14 filing, planning and management.³⁶⁸ LPSCO simply couldn't operate without these tax
15 services. Taxes are paid on behalf of LPSCO at the parent level as part of a consolidated
16 United States tax return. Tax services are provided by third parties, including KPMG.³⁶⁹
17 At hearing, Mr. Rowell acknowledged the necessity of these tax services.³⁷⁰

18 Audit services are likewise necessary to ensure that the *Regulated Utilities* are
19 operated in a manner that meets audit standards and regulatory requirements.³⁷¹ Without
20

21 ³⁶⁵ Tremblay Rj. at 9 – 11, 16 – 20, Ex. GT-RJ1 at 12 – 14.

22 ³⁶⁶ *Id.*

23 ³⁶⁷ *Id.* at 9 – 20, Ex. GT-RJ1.

24 ³⁶⁸ *Id.* at 19 – 21, Ex. GT-RJ1 at 12 – 14.

25 ³⁶⁹ *Id.*

26 ³⁷⁰ Tr. at 917 (“...I could say if APT is providing these tax services to LPSCO, then certainly they should be allowed.”).

³⁷¹ Tremblay Rj. at 19 – 22, Ex. GT-RJ1 at 12 – 15.

1 these services, LPSCO would not have a readily available source of capital funding.³⁷²
2 These financial controls also are required by the rules of the Toronto Stock Exchange.
3 Again, at hearing, Mr. Rowell acknowledged the necessity and benefits of audit services,
4 the Board of Trustees and other services for publicly traded companies.³⁷³

5 d. Administrative Costs and Overhead.

6 Finally, administrative costs incurred by APT such as rent, depreciation of office
7 furniture, depreciation of computers, and general office costs are required to house all of
8 the APT services mentioned above.³⁷⁴ Staff's and RUCO's attempt to deny these costs
9 should be rejected.

10 6. Staff's and RUCO's Other Red Herrings Should Be Ignored.

11 As noted above, Staff's and RUCO's primary reasons for disallowing the APT
12 costs are transparent. In today's world, it can't be stressed enough how much utilities
13 benefit from strategic direction on long term capital and operational needs and
14 requirements. Boiled down, the services provided by APT are part of the APIF corporate
15 model, which allows LPSCO to provide high quality, cost-effective service.

16 Staff and RUCO do *not* dispute that LPSCO is providing high quality utility
17 service. But they do raise a host of other red herrings in an effort to disallow the APT
18 costs. These red herrings should be ignored. To start, Staff argues that APIF's and
19 LPSCO's operation as for-profit entities somehow taints the APT costs.³⁷⁵ This is another
20 way of saying that the APT costs generate revenue for APIF's investors. Not only is that
21 not true for the reasons noted above, the mere fact that APIF operates for a profit doesn't

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23 ³⁷² *Id.*

24 ³⁷³ Tr. at 920 ("...it is my position that to the extent that APT provides auditing services for LPSCO, they
25 should be recoverable."); *Id.* at 924 ("There are expenses associated with being listed."); *Id.* at 944
26 ("...publicly traded companies are required to have a board" of directors/trustees).

³⁷⁴ Tremblay Rj. at 20, Ex. GT-RJ1 at 14.

³⁷⁵ Michlik Wastewater Sb. at 8 - 9.

1 necessarily imply that the APT costs are improper.³⁷⁶ Instead, the fact that APIF is in the
2 business of making a profit provides additional incentive to tightly control these corporate
3 costs, considering that approximately 73% are allocated to the non-regulated business.³⁷⁷

4 Yet another concern expressed by Staff and RUCO is potential subsidization by
5 LPSCO's ratepayers for business operations by unregulated entities. As stated in the
6 NARUC Guidelines of Cost Allocations and Affiliate Transactions, the "objective of the
7 affiliate transactions' guidelines is to lessen the possibility of subsidization in order to
8 protect monopoly ratepayers..."³⁷⁸ Here, there is no evidence of subsidization by
9 LPSCO's ratepayers. Rather, approximately 73% of the entire Central Office Cost pool is
10 allocated to unregulated electric facilities. Only 27% of the cost pool is allocated to
11 regulated utilities, such as LPSCO. In fact, LPSCO only gets 13% of the total APT costs.
12 The APT costs are allocated to LPSCO from Liberty Water based on customer count,
13 which is a reflection of LPSCO's use and need for those services provided by APT.
14 What's ironic about Staff's subsidization argument is that, under Staff's allocation
15 methodology, the other facilities owned by APIF would subsidize the APT services
16 provided to LPSCO and the seven Arizona utilities. Even Mr. Michlik acknowledged that
17 such subsidization is improper and unfair.³⁷⁹

18 Finally, Staff's and RUCO's arguments that LPSCO has failed to properly invoice
19 and document the APT cost are meritless and, frankly, inconsistent. The inconsistency
20 arises from Mr. Michlik's arbitrary and undocumented determination that 90% of the APT
21 costs are attributable to APT/APIF.³⁸⁰ To say the least, Mr. Michlik did not document

23 ³⁷⁶ Tremblay Rj. at 13 – 14.

24 ³⁷⁷ *Id.*

25 ³⁷⁸ See NARUC Guidelines on Cost Allocations and Affiliate Transactions at 3.

26 ³⁷⁹ Tr. at 1172 – 1173.

³⁸⁰ Michlik Wastewater Dt. at 16.

1 such allocation, which makes his criticisms of LPSCO's documentation hard to swallow.
2 This argument is extremely frustrating. Staff propounded and the Company answered
3 dozens of data requests on operating and administrative expenses, including the cost
4 allocations. The Company provided all invoices over \$5,000 relating to these allocated
5 costs and was willing to provide any further invoices below that amount upon request. It
6 is unclear exactly what Staff felt was missing, because the gist of Mr. Michlik's testimony
7 was that he reviewed the invoices and determined that 90% of those cases related to APIF,
8 and not LPSCO.³⁸¹ On the merits, the combination of the Liberty Water Cost Allocation
9 Methodology paper and the thousand of pages of invoices provided by LPSCO more than
10 document the APT costs.

11 **B. The Commission Should Approve The APT Costs In Order To Ensure**
12 **That LPSCO Continues to Provide High Quality Utility Service To**
13 **Customers.**

14 Resolution of this Central Cost Allocation issue places Liberty Water at a
15 crossroads. If the Commission adopts Staff's or RUCO's disallowances, then the
16 Commission effectively will be denying all cost allocations from APT and rejecting
17 Liberty Water's business model. Not only is such decision not supported by substantial
18 evidence, but Staff's attempt to dictate how Liberty Water/LPSCO does business violates
19 Arizona law.³⁸² Even further, neither Staff nor the Commission has provided any
20 guidance on acceptable cost allocation methods available to Liberty Water. Instead of
21 offering direction on cost allocations, Staff has applied a generic presumption to reject all

22 ³⁸¹ *Id.*; Tr. at 1207. In making that determination, Mr. Michlik admitted he did not perform any
23 comparative analysis and, instead, he "simply determined" that allocating 90% of the APT costs to APIF
was appropriate. Tr. at 1207 - 1208.

24 ³⁸² *See Southern Pac. Co. v. Ariz. Corp. Comm'n*, 98 Ariz. 339, 343, 404 P.2d 692, 696 (1965) ("...plainly
25 it is not the purpose of regulatory bodies to manage the affairs of the corporation. It must never be
26 forgotten that, while the state may regulate with a view to enforcing reasonable rates and charges, it is not
the owner of the property of public utility companies, and is not clothed with the general power of
management incident to ownership.") (citations omitted).

1 of the APT allocations. Any such Commission decision effectively would force LPSCO
2 to disavow its shared services model and revert to operating as a standalone utility.³⁸³

3 Ultimately, the Commission should be looking at APIF's corporate model as an
4 integrated whole. On the whole, LPSCO's costs and costs per customer compare very
5 favorably to other Arizona utilities, and given the added benefits provided by the APIF
6 corporate model in terms of corporate governance, and access to capital and stability,
7 APIF's corporate model should be approved. The Commission should be encouraging
8 owners like APIF who are willing to invest capital in this state with an overriding
9 corporate model of good governance. If the APT cost allocations are disallowed as
10 suggested by Staff and RUCO, the Commission simply can't expect LPSCO to provide
11 the same level of service with the same level of operating expenses.

12 **C. Other Operating Expense Issues in Dispute**

13 1. Performance Based Salaries Are Not Inherently Unreasonable.

14 Whether employee compensation is paid as all base salary, or in part, as incentive
15 or at-risk pay, the costs are part of the cost of service.³⁸⁴ Customers are not harmed
16 because a Liberty Water employee is paid a salary of \$42,000 with the opportunity to earn
17 a \$3,000 "bonus" for performance, instead of simply being paid \$45,000 in annual salary.
18 Liberty Water has actually found that this compensation system improves overall
19 employee performance, a benefit to ratepayers since that higher performance is being
20 delivered at no higher cost.³⁸⁵

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23 ³⁸³ In his trial testimony, Mr. Michlik agreed that, if the APT cost allocations are denied by the
24 Commission, then APT could stop providing those services to LPSCO and, according to Mr. Michlik, "[i]t
25 would be the company's decision. We can't run the companies here, so it would be up to the company."
26 Tr. at 1212.

³⁸⁴ Sorensen Amended Rb. at 13:7-8.

³⁸⁵ Sorensen Rj. at 13:13-15.

1 This is not to say that “bonuses” are not subject for potential abuse; the Company
2 accepts that potentially they are. But Mr. Michlik has not testified that the Company has
3 abused the process by, for example, paying Mr. Sorensen a bonus equal to 150 percent of
4 his salary and then hoping ratepayers pick up the tab. This is not *AIG*.³⁸⁶ Rather, Staff’s
5 concern is that there is no guarantee that the bonus portion of the compensation will be
6 paid.³⁸⁷ Staff is right; there is no guarantee. Nor is there a guarantee that base wages
7 won’t go up or down after the test year. There is also no guarantee that the Company’s
8 test year purchased power expense, chemical expense, bad debt expense, or any other
9 expense will be the same as the test year. But that does not change the fact that the test
10 year is presumed normal.³⁸⁸ Nor does it justify Staff’s excessive remedy – disallowing all
11 “bonus” amounts actually paid during the test year.³⁸⁹

12 2. RUCO Removes Necessary Costs As “Non-Recurring.”

13 During the test year, LPSCO incurred \$19,784 for effluent clean up and \$16,428
14 for grounds maintenance and line cleaning.³⁹⁰ The Company also incurred \$58,147 for
15 fuel for power production, however, it proposes to normalize this expense at a test year
16 level of \$37,838.³⁹¹ Staff never questioned the effluent, cleaning and maintenance costs;
17 and Mr. Michlik specifically adopted the Company’s proposed normalization
18 adjustment.³⁹² RUCO rejects all of these expenses as non-recurring or unnecessary.³⁹³

19
20 _____
21 ³⁸⁶ *Id.* at 13:3-13.

22 ³⁸⁷ Tr. at 1231:25 – 1234:4.

23 ³⁸⁸ *E.g., Chaparral City Water Company*, Decision No. 71308 (October 21, 2009) at 22 – 23.

24 ³⁸⁹ Michlik Water Sb. at 11; Michlik Wastewater Sb. at 9.

25 ³⁹⁰ Bourassa Amended Rb. at 41:4-6. The “effluent clean up” is actually for maintaining the site where the
26 Company legally disposes of effluent; an open farm field where the effluent is allowed to feed plants or
crops or seep back into the ground and recharge the aquifer.

³⁹¹ Company Final Schedule C-1, page 1 (water).

³⁹² Michlik Water Sb. at 8:6-9.

1 RUCO's entire explanation for reducing the water division's operating expenses is
2 that the power costs were inappropriately included in test year expenses.³⁹⁴ As discussed
3 above, the test year is presumed normal and the Company's costs are presumed prudent
4 and necessary absent evidence to the contrary.³⁹⁵ Ms. Rowell's unexplained and
5 unsupported testimony is hardly substantial evidence sufficient to rebut the Company's
6 test year expenditure. Likewise, Ms. Rowell could not explain her adjustment to remove
7 the costs from the wastewater division's expenses. She did not know what beneficial
8 reuse means, she did not know why the clean-up and reseeded of farmer's property where
9 effluent was stored might be necessary, and she made no effort to determine whether the
10 costs she was rejecting actually were normal and recurring.³⁹⁶ Instead, Ms. Rowell stuck
11 to her position that she only looks at invoices and these invoices didn't satisfy her.³⁹⁷ This
12 is insufficient basis to disallow roughly \$95,000 of operating expenses.

13 3. RUCO'S Bad Debt Expense for Wastewater Is Made-Up.

14 The Company and Staff agree to a bad debt expense level of \$22,098 for the
15 wastewater division.³⁹⁸ This amount was based on Staff's proposed normalization, which
16 Mr. Bourassa adopted.³⁹⁹ Normalization is certainly appropriate here; bad debt expense is
17 one expense that is impacted by the economy, a problem made worse by the difficulty
18 utilities have in discontinuing sewer service.⁴⁰⁰ In contrast, RUCO's recommended bad

19 ³⁹³ RUCO Final Schedule 4, page 1 of 16 (water) and page 5 of 20 (wastewater). RUCO actually
20 recommends \$1766 as the test year level of fuel for power expense, the residual amount left in the subject
account after RUCO's adjustment. S. Rowell Dt. at 7.

21 ³⁹⁴ S. Rowell Dt. at 7:11-14.

22 ³⁹⁵ Decision No. 71308 at 22 – 23.

23 ³⁹⁶ Tr. at 771:1 – 774:23.

24 ³⁹⁷ *Id.* at 771:24 – 772:3, 774:15-19.

25 ³⁹⁸ Company Final Schedules C-1, page 1 and C-2, page 6 (wastewater); Staff Final Schedules JMM-
WW12 and JMM-WW18.

26 ³⁹⁹ *Id.*; see also Michlik Wastewater Dt. at 19:1-13; Bourassa Amended Rb. at 3 – 5.

⁴⁰⁰ See Tr. at 766:13 – 767:4.

1 debt expense level has no rational basis. Having found the test year number higher than
2 expected, Ms. Rowell “came up” with a number using the bad debt expense level for the
3 water division.⁴⁰¹ In doing so, she ignored every other piece of evidence, including
4 admittedly undisputed evidenced that LPSCO has averaged approximately \$21,000 a year
5 in bad debt expense for its sewer division for the last three years.⁴⁰² As such, RUCO’s
6 recommended \$3,041 level of bad debt expense, less than 10 percent of the test year
7 amount and only 14 percent of the 3-year average,⁴⁰³ is unsupportable and must be
8 rejected in favor of Staff’s recommended normalized amount of \$22,098.

9 **D. LPSCO Should Be Authorized Its Requested Rate Case Expense And**
10 **Given A Fair and Adequate Opportunity To Recover The Amount**
11 **Authorized**

12 LPSCO seeks to recover total rate case expense of \$500,000, or \$250,000 per
13 division, amortized over 3 years.⁴⁰⁴ This is an increase of \$80,000, or \$40,000 per
14 division as compared to the Company’s original estimate.⁴⁰⁵ The increase was generally
15 due to (1) complications raised by three different interventions and the issues raised by
16 those parties; (2) the hearing taking longer than anticipated, which led to higher rate case
17 expense through higher legal and consultant fees and increased transcript costs; and
18 (3) due to the fact that positions taken by RUCO led to additional expense for discovery
19 and procedural matters, plus the costs of two expert witnesses.⁴⁰⁶ Still the amount
20 requested is less than the Company will actually incur; as of January 15, 2010, the last day
21 of trial, LPSCO had already incurred more than \$435,000 in actual rate case expense.
22 This amount is exclusive of any costs for transcripts, final schedules, briefing, the ROO,

22 ⁴⁰¹ *Id.* at 768:14-17.

23 ⁴⁰² *Id.* at 768:21 – 769:10 *discussing* Bourassa Rj. at 29:10-17.

24 ⁴⁰³ *See* RUCO Final Schedule 4, page 1 of 20 (wastewater).

25 ⁴⁰⁴ Company Final Schedule C-1, page 1 (water and wastewater).

26 ⁴⁰⁵ Company Final Schedule C-2, page 12 (water) and page 11 (wastewater).

⁴⁰⁶ Tr. at 1375:18 – 1376:25.

1 exceptions, and Open Meeting, or any costs of Phase 2 regarding the HUF tariff. The
2 Company has accepted that it will have to shoulder all of the expenses above its requested
3 amount of rate case expense, further illustrating the reasonableness of its request.

4 No party questioned the Company about the increased rate case expenses it was
5 incurring or requesting for recovery. Nevertheless, Staff and RUCO recommend rate case
6 expense of \$420,000, or \$210,000 per division amortized over 5 years.⁴⁰⁷ This amount
7 coincides with the Company's initial estimate and, therefore, ignores the additional factors
8 that increased the Company's costs. To the extent Staff and RUCO explain the basis for
9 opposing the increased amount, the Company will address their arguments in its reply
10 brief.

11 The remaining dispute is over the amortization period. LPSCO recommends a
12 three-year amortization period consistent with Liberty Water's philosophy of filing rate
13 cases at regular intervals.⁴⁰⁸ A three-year amortization period would also coincide with
14 the end of the Company's proposed phase-in of rates over 3 years, at which time the
15 Company would likely have to come in again for its rates to be set.⁴⁰⁹ A three-year
16 amortization period is also consistent with the recommendations of the applicants, RUCO
17 and Staff in the concurrently pending Global Water rate cases.⁴¹⁰

18 Like LPSCO, Global Water is a holding company with several regulated utility
19 subsidiaries. Global acquired its utility subsidiaries over the past several years and they
20 are now before the Commission seeking rate relief for the first time. It has been more
21 than 12 years since Valencia Water last had its rates determined and Palo Verde Utilities
22

23 ⁴⁰⁷ Staff Final Schedules JMM-W13 and JMM-WW12; RUCO Final Schedule 4, page 1 of 16 (water) and
24 page 1 of 20 (wastewater).

25 ⁴⁰⁸ *E.g.*, Sorensen Amended Rb. at 11:1-12; Sorensen Rj. at 1:17 - 2:2.

26 ⁴⁰⁹ Tr. at 1236:23 - 1237:13.

⁴¹⁰ Ex. A-23; Tr. at 524:14 - 525:3.

1 and Santa Cruz Water, both formed in 1999, have never had a rate case.⁴¹¹ Given the
2 obvious similarities, a three-year amortization period should work for LPSCO if it works
3 for Global. In fact, Staff already believes it can compare Liberty Water's utilities to
4 Global Water's utilities for purposes of determining a reasonable level of a different
5 operating expense.⁴¹²

6 Nevertheless, Staff and RUCO recommend a five-year amortization period because
7 LPSCO has not been in for rates since 2002.⁴¹³ However, neither Staff's nor RUCO's
8 witness could explain the differential treatment between similarly situated utilities in
9 concurrently pending rate cases.⁴¹⁴ Even worse, Staff's longer amortization period places
10 the Company at risk of not recovering its authorized rate case expense if Staff's point of
11 view should prevail. Staff's witness admitted that he was trying to create a scenario
12 where the utility forfeits unrecovered rate case expense if it comes in before the
13 amortization period runs.⁴¹⁵ This is not equitable.⁴¹⁶

14 If the Commission is truly concerned about utilities staying out longer than the
15 amortization period and over collecting, then the remedy is a surcharge to ensure the
16 utility collects only the amount authorized, no more and no less.⁴¹⁷ Setting up the
17 Company to forfeit potentially hundreds of thousands of dollars because it seeks rate relief
18 is simply wrong. The law abhors forfeiture.⁴¹⁸ Even Ms. Rowell agreed with that.⁴¹⁹

19 ⁴¹¹ Ex. A-23.

20 ⁴¹² See Transcript from November 25, 2009 hearing at 781-782, *Black Mountain Sewer Corporation*,
Docket No. SW-02361A-08-0609.

21 ⁴¹³ Michlik Water Sb. at 20:1-4; Michlik Wastewater Sb. at 18:5-8; Tr. at 760:18 – 761:5.

22 ⁴¹⁴ Tr. at 761:23 – 763:11, 1237:17-24.

23 ⁴¹⁵ *Id.* at 1235:13-16, 1236:5-9.

24 ⁴¹⁶ *Id.* at 1368:5 – 1370:7.

25 ⁴¹⁷ *Id.* at 1370:10 – 1373:19.

26 ⁴¹⁸ *L. Harvey Concrete, Inc. v. Agro Const. & Supply Co.*, 189 Ariz. 178, 183, 939 P.2d 811, 816 (Ariz. Ct.
App. 1997); Restatement (Second) of Contracts § 227 (1981).

⁴¹⁹ Tr. at 765:12-13, 766:3-11.

1 **IV. COST OF CAPITAL**

2 **A. Capital Structure – No Dispute**

3 Staff, RUCO and the Company each recommend a capital structure of
4 approximately 17-18 percent debt and 82-83 percent equity.⁴²⁰ Notably, because LPSCO
5 has debt in its capital structure, RUCO did not recommend a hypothetical capital structure
6 for LPSCO.⁴²¹ Consequently, as Mr. Rigsby testified, the parties are “pretty much in
7 agreement” on the capital structure.⁴²²

8 **B. Return on Equity**

9 As mentioned, LPSCO’s affiliate BMSC also has a pending rate case before the
10 Commission. Judge Nodes is presiding over both matters. The test year in this rate case
11 is only 90 days later than the test year in that rate case and the two cases went to trial
12 roughly six weeks apart. LPSCO has the same cost of capital witness as BMSC, and the
13 same witness has appeared in both rate cases for Staff and RUCO. Each of these
14 witnesses has used the same DCF and CAPM methodology and inputs in this case as used
15 in the BMSC rate case.⁴²³ Notwithstanding different final numbers, there are no material
16 differences in the cost of capital analysis.⁴²⁴

17 As such, like BMSC, LPSCO objects to RUCO’s use of a sample group of gas
18 distribution utilities in its cost of equity analysis because gas utilities are not comparable

19 _____
20 ⁴²⁰ Company Final Schedule D-1 (water and wastewater); RUCO Final Schedule WAR-1, page 1 of 3; Manrique Sb. at 5:1.

21 ⁴²¹ Tr. at 970:2-7. Notably, LPSCO agrees with Mr. Rigsby in this case eliminating any dispute with
22 RUCO over this issue. However, neither the Company, Liberty Water, nor undersigned counsel are in
23 agreement that a hypothetical capital structure is appropriate in other cases.

24 ⁴²² Id. at 994:2-3. During trial, counsel for the City questioned Mr. Rigsby regarding hypothetical capital
25 structures. The City did not make a cost of capital recommendation, nor did it file Final Schedules. As
26 such, LPSCO assumes that the City does not intend to now advance argument that a hypothetical capital
structure should be adopted. There is no evidence in the record in this rate case to support such adoption.
Id. at 993:23 – 994:3.

⁴²³ *Id.* at 991:1-10, 1141:3-13.

⁴²⁴ *Id.*

1 to the Company because they have significantly less market risk. The Commission has
2 recognized this problem in the past.⁴²⁵ LPSCO also objects to RUCO's use of a geometric
3 mean in the CAPM. It is well established that the arithmetic average most accurately
4 approximates the expected future rate of return and is the theoretically correct method for
5 estimating the cost of capital.⁴²⁶ But like the use of total treasury returns instead of
6 income returns, and the failure to consider current market risk, all of these efforts reduce
7 the ROE. As a result, while Mr. Rigsby's recommended ROE in this case is nearly 80
8 basis points higher than in the BMSC rate case, adoption of RUCO's recommended ROE
9 9.0 percent will still make it more difficult for LPSCO to attract capital.⁴²⁷

10 So too would Staff's recommended ROE of 9.2 percent. This is 20 basis points
11 lower than Staff's recommended 9.4 percent ROE in the BMSC rate case. This is curious,
12 given that LPSCO has more debt in its capital structure for ratemaking purposes than
13 BMSC, and therefore more financial risk. Equally curious is the fact that Staff calculated
14 the same Hamada adjustment for both BMSC and LPSCO, despite the differences in their
15 capital structures. Staff used the same financial risk adjustment methodology in both
16 cases,⁴²⁸ a method that fails to account for the differences in LPSCO relative to the sample
17 companies and inappropriately uses book values in a market-based model.⁴²⁹
18 Unfortunately, Staff does not appear to allow its cost of capital witness to exercise any
19 independent judgment,⁴³⁰ which may explain the seemingly incongruous results when the
20

21 _____
22 ⁴²⁵ *Arizona Water Company*, Decision No. 66849 (March 19, 2004) at 21; see also *Arizona-American*
Water Company Decision No. 67093 (June 30, 2004) at 27.

23 ⁴²⁶ See Bourassa COC Rb. at 18 citing *Morin*.

24 ⁴²⁷ See Rebuttal Testimony of Gregory S. Sorensen, filed October 20, 2009 in Docket No. SW-02361A-08-
0609, at 10:8-11:17.

25 ⁴²⁸ Tr. at 1141:14-16.

26 ⁴²⁹ Bourassa COC Rb. at 5-10.

⁴³⁰ Tr. at 1141:17-25.

1 two pending rate cases are compared. It also supports adoption of LPSCO's requested
2 ROE of 12 percent.⁴³¹

3 **V. RATE DESIGN**

4 **A. The Wastewater Rate Design Is Not In Dispute, Except the Effluent**
5 **Rate**

6 LPSCO, Staff and RUCO do not propose to change the rate design for its
7 wastewater division and each spreads its proposed increases equally across all service
8 classes.⁴³² The only issue in dispute is RUCO's recommended effluent rate, which the
9 Company opposes.

10 The Company proposes to continue using market rates to sell effluent.⁴³³ Staff
11 concurs.⁴³⁴ According to RUCO, these rates are "excessively low."⁴³⁵ According to
12 Ms. Rowell, effluent is a valuable resource and a higher price will help offset rate
13 increases to other customer classes.⁴³⁶ But Ms. Rowell did not consider the fact that
14 effluent buyers have alternatives, including groundwater that can be pumped at lower
15 costs than RUCO's effluent cost.⁴³⁷ Nor did she consider the cost of disposing of effluent
16 that can no longer be sold because the price is too high.⁴³⁸ Fortunately, the Company has
17 considered all of these factors in proposing an effluent rate mechanism that encourages
18 the sale of effluent rather than necessitates payment to dispose of it.⁴³⁹ The market rates
19 for effluent should be continued as recommended by the Company and Staff.

20 ⁴³¹ Company Final Schedule D-1 (water and wastewater).

21 ⁴³² Bourassa Dt. at 43 – 45; Bourassa Amended Rb. at 59:19-23.

22 ⁴³³ Company Final Schedule H-3, page 1 (wastewater).

23 ⁴³⁴ Staff Final Schedule PMC-1 WW, page 1 of 2.

24 ⁴³⁵ S. Rowell Dt. at 23:22-23.

25 ⁴³⁶ *Id.* at 24:2-4.

26 ⁴³⁷ Tr. at 794:21 – 795:8; 802:15 – 803:4.

⁴³⁸ *Id.* at 802:11-14.

⁴³⁹ Sorensen Amended Rb. at 30:5-21; Sorensen Rj. at 2:3 – 3:11.

1 **B. LPSCO and the City Propose a Rate Design that Most Equitably**
2 **Balances the Competing Interests in Designing Rates**

3 1. Overview of LPSCO and The City's Proposed Rate Design.

4 Consistent with recent Commission decisions, the Company proposed an inverted
5 block rate design in its direct filing.⁴⁴⁰ Inverted block rate designs are conservation-
6 oriented rate designs that reflect social policy, and as a result, deviate in certain respects
7 from cost of service principles.⁴⁴¹ Nevertheless, the cost of service is still relevant to
8 setting rates, and as result, the Company prepared a cost of service study.⁴⁴² Notably,
9 neither Staff nor RUCO prepared a cost of service study, nor did they question the results
10 of the Company's cost of service study.⁴⁴³ The cost of service study showed that under
11 the existing rates, the two largest groups of residential customers, customers on 3/4-inch
12 and 1-inch meters, are not paying their cost of service and are the primary cause of the
13 Company's current negative rate of return.⁴⁴⁴

14 Mr. Bourassa used the information provided by the Company's cost of service
15 study to develop his initial rate design proposal, which maintained a subsidy of residential
16 customers on smaller meters, but moved the rates for those customers closer to their cost
17 of service.⁴⁴⁵ At the same time, the Company's inverted block rate design provides a
18 strong price signal, encouraging water conservation. Mr. Bourassa's proposed rate design

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20
21 ⁴⁴⁰ Bourassa Dt. at 17 – 18.

22 ⁴⁴¹ *Id.* at 19:10-14, 21:9-15.

23 ⁴⁴² Bourassa Dt. at 19:24 – 33:12.

24 ⁴⁴³ See Chavez Sb. at 15 – 19; *see generally*, Tr. at 774:25 – 775:5. Mr. Bourassa and Mr. Darnall, the
25 witness for the City, did disagree on some aspects of Mr. Bourassa's cost of service study. Bourassa
26 Amended Rb. at 56:14 – 58:17; Bourassa Rj. at 45:20 – 47:5. These differences of opinion between
experts do not undermine the jointly proposed water rate design.

⁴⁴⁴ Bourassa Dt. at 32:14-24.

⁴⁴⁵ *Id.* at 33:1-12; Bourassa Rj. at 38:11-15.

1 was then modified at the rebuttal stage to include a rate for bulk customers like Goodyear
2 that purchase water from LPSCO for resale.⁴⁴⁶

3 During trial, the Company and the City got together, resolved their differences of
4 opinion, and proposed a modified, inverted block rate design.⁴⁴⁷ This joint proposal
5 differs from LPSCO's proposed rate design in several ways. First, a third tier was added
6 for 1-inch and smaller meters.⁴⁴⁸ Second, the City's break-over points were adopted and
7 lower monthly minimum service charges were proposed.⁴⁴⁹ Third, Goodyear was treated
8 as an 8-inch customer with a monthly minimum service charge and a commodity rate.⁴⁵⁰
9 The rate design proposed by the City and LPSCO will work with any revenue increase
10 with minor modification.⁴⁵¹

11 There are several important advantages to the City and LPSCO's joint rate design
12 proposal. First, by adding a third tier, this inverted block rate design provides a stronger
13 price signal, further encouraging water conservation.⁴⁵² Second, 3/4-inch and 1-inch
14 meter customers are moved closer to the cost of service, and the subsidy being provided to
15 these customers by the commercial and irrigation customers is reduced.⁴⁵³ Third, the City
16 and LPSCO's rate design better distributes the usage on a volumetric basis within the

17
18 ⁴⁴⁶ Bourassa Amended Rb. at 51:2-9. This modification of the proposed rate design was consistent with
19 LPSCO's acceptance of RUCO's rebuttal adjustment to include revenues from bulk water sales to
20 Goodyear. *Id.* at 31:12-15. Initially, the Company had excluded such revenues as not likely to continue
21 past the test year. Bourassa Dt. at 14:3-7 *citing* Sorensen Dt. at 13.

22 ⁴⁴⁷ Exs. A-20, A-21 and A-22 (reflecting the Company's revenue requirement). *See also* Tr. at 652:19-22.

23 ⁴⁴⁸ Tr. at 510:10 - 513:2.

24 ⁴⁴⁹ *Id.* at 611:7-19. Initially, 44% of the revenue came from the monthly minimums under LPSCO's rate
25 design. Under the joint proposal, approximately 37% to 38% of the revenue will come from the monthly
26 minimums, an allocation between fixed and commodity rates much closer to the existing rates. *Id.*

27 ⁴⁵⁰ *Id.*

28 ⁴⁵¹ *Id.* at 508:10-17. The City and LPSCO do not agree on the revenue requirement. *Id.* at 526:19 - 527:2;
29 Ex. LP-4.

30 ⁴⁵² Tr. at 656:24 - 657:10, 671:7 - 672:12, 675:1 - 676:18.

31 ⁴⁵³ *Id.* at 642:18 - 643:1, 656:6-12.

1 classes (meter sizes).⁴⁵⁴ This results in a smoothing out of rate increases to customers
2 who cannot do much to conserve.⁴⁵⁵ Fourth, by recognizing these limits on conservation
3 by smaller users, this rate design promotes revenue stability.⁴⁵⁶ Fifth, by recognizing
4 Goodyear's unique situation, the City and LPSCO's proposal serves the public interest by
5 allowing Goodyear continued access to a lower cost water supply alternative and reduces
6 the risk that the Company will suffer a revenue shortfall of nearly \$900,000 if Goodyear
7 elects to stop purchasing water from LPSCO.⁴⁵⁷

8 In sum, the rate design proposed by the City and LPSCO is consistent with the
9 Commission's goal of encouraging water conservation, while adhering to cost of service
10 principles and moving customers on smaller meters closer to the cost of service.

11 2. The Primary Goal of Staff's and RUCO's Rate Designs Is Revenue
12 Shifting; Conservation Is Just the Trojan Horse.

13 The rate designs proposed by Staff and RUCO are intended to shift revenue
14 recovery from residential customers on smaller meters to the commercial and irrigation
15 customers. As Mr. Chavez and Ms. Rowell admitted, their rate designs are intended to
16 ameliorate the impacts of rate increases on residential customers.⁴⁵⁸ Respectfully, these
17 concerns are better addressed through a low-income tariff, and in this case, rate phase-ins
18 as discussed below. Water conservation is simply a smoke screen to justify ignoring cost
19 of service principles. Consequently, Staff's and RUCO's rate designs are badly flawed
20 and should not be adopted.

21
22 ⁴⁵⁴ *Id.* at 656:13-21, 660:14 – 664:20.

23 ⁴⁵⁵ *Id.* at 661:25 – 662:18.

24 ⁴⁵⁶ *Id.* at 661:1–17, 663:11-13, 665:14-18, 669:14-23.

25 ⁴⁵⁷ Bourassa Rj. at Exs. TJB-RJ3 and TJB-RJ5.

26 ⁴⁵⁸ Tr. at 1262:13 – 1263:8 (revenue recovery was intentionally shifted from residential customers to commercial and industrial customers); *Id.* at 695:17 – 697:1.

1 If water conservation is really the Commission's goal, it must adopt the City and
2 LPSCO's rate design, which is supported by evidence showing why and how that rate
3 design promotes conservation. The only evidence Staff and RUCO have mustered in
4 favor of the "conservation" aspects of their rate designs is that they are inverted block rate
5 designs.⁴⁵⁹ But the mere fact that a rate design includes inverted commodity rate blocks
6 does not mean that it will actually promote conservation, particularly when the rate design
7 involves significant shifts in revenue recovery between customer classes and results in
8 substantial numbers of customers receiving service at rates well below the cost of
9 service.⁴⁶⁰

10 Perhaps for this reason, Staff and RUCO have not provided a shred of evidence
11 that their rate designs will actually promote water conservation (which also explains their
12 lack of concern over revenue erosion). The only "price signal" that Staff and RUCO are
13 sending with their rate designs is that residential customers are entitled to be subsidized by
14 business owners. They won't do much for conservation; but they will signal the death of
15 cost of service rate making in Arizona.

16 By way of illustration of these so-called "fair and reasonable" rate designs,
17 consider the following facts: if the Commission were to adopt Staff's revenue
18 requirement, including its overall rate of return, 585 of LPSCO's water utility customers,
19 those receiving service on 2-inch meters, would be paying rates that include an
20 unreasonable rate of return of 22%.⁴⁶¹ Of course, those 585 customers are getting a good
21 deal compared to the 23 customers on 4-inch meters, which would pay a return of 32%.
22 And both of those customer classes would get a screaming deal relative to Goodyear,
23

24 _____
⁴⁵⁹ *Id.* at 1262:17-21.

25 ⁴⁶⁰ Bourassa Rj. at Exs. TJB-RJ3 and TJB-RJ5.

26 ⁴⁶¹ *Id.* at Ex. TJB-RJ3.

1 which will be buying bulk water for resale at rates that include a return of over 200%.⁴⁶²
2 By contrast, the residential customers are paying varying returns all under the overall rates
3 of return proposed by all parties in this case. Water conservation is certainly an important
4 policy goal. But promoting conservation does not mean that the cost of service should be
5 ignored. Indeed, selling water to large numbers of customers at rates below the cost of
6 service is hardly an appropriate price signal. The reality is that the Staff and RUCO rate
7 designs are intended to promote subsidies between customer classes, rather than
8 promoting water conservation in a fair and non-discriminatory manner.

9 The lack of any real analysis concerning the impact of the Staff and RUCO rate
10 designs is reflected in the proposed rates for water that Goodyear buys for resale. During
11 the test year, Goodyear paid LPSCO \$403,707 for this water.⁴⁶³ The undisputed evidence
12 is that Goodyear buys water for resale because it is less costly for Goodyear to do so than
13 to pump its own water.⁴⁶⁴ Staff and RUCO propose to more than double the revenue
14 coming from bulk sales to Goodyear.⁴⁶⁵ This will eliminate the cost advantage and cause
15 Goodyear to cease buying water from LPSCO, eliminating \$900,000 in revenue. At that
16 point LPSCO will (1) need rate relief immediately; (2) face forfeiture of hundreds of
17 thousands of dollars of rate case expense already incurred based on Staff's position;⁴⁶⁶ and
18 (3) incur additional rate case expense in order to recover the nearly \$1 million Staff and
19 RUCO are trying to shift away from those incurring the cost of service; 3/4" and 1" meter
20 residential customers. Is this scenario in the public interest? Not with a public-private
21 partnership proposed rate design available.

22
23 ⁴⁶² *Id.*

24 ⁴⁶³ Company Final Schedule H-1, page 1 (water).

25 ⁴⁶⁴ Tr. at 108:1-10.

26 ⁴⁶⁵ Bourassa Rj. at Exs. TJB-RJ3 and TJB-RJ5.

⁴⁶⁶ Tr. at 1236 - 1237.

1 3. Phased-In Rates Are Acceptable to LPSCO as Long as the Company
2 Is Made Whole.

3 Despite every argument made by the Company in the preceding portions of this
4 brief, it would be naive to think this Commission is not concerned over the lingering
5 impacts of the recently ended recession and the impact of considerable rate increases on
6 ratepayers. As Judge Nodes correctly commented, the primary concern of customers
7 appears to be “just the sudden magnitude of the increases.”⁴⁶⁷ While this sudden increase
8 is actually a fact of life in the water and wastewater industries (i.e. lumpy capital
9 expenditures cause sudden, large increases), the Company heard the Chair’s request that
10 the parties present evidence regarding the phasing in of rates.⁴⁶⁸

11 Only the Company took up the charge from Chairperson Mayes and presented
12 evidence to support a phase-in of rates during the hearing. As proposed, the Company’s
13 phase-in would mitigate the impact of “sudden” increases by allowing only 80 percent of
14 the increased rates to be collected in year one.⁴⁶⁹ That phase-in also meets the
15 requirement that LPSCO be made whole in year three by authorizing higher than
16 authorized rates in order to recover the shortfall in revenues collected under year one, plus
17 carrying costs calculated at the WACC until LPSCO is made whole.⁴⁷⁰ At the end of year
18 three, the rates would either have to automatically reset to the authorized rates, or another
19 rate case will be required.⁴⁷¹ While the Company shares Staff’s often expressed concern
20

21 ⁴⁶⁷ *Id.* at 57:24-58:1.

22 ⁴⁶⁸ *Id.* at 33 – 34.

23 ⁴⁶⁹ Company Final Schedules, Phase-In H Schedules (water and wastewater).

24 ⁴⁷⁰ *Id.*; see also Ex. A-40. As noted above, unless the Commission wishes for the “129%” rate to continue
once LPSCO is made whole, the rates must automatically reset to the 100% level or another rate case will
be required.

25 ⁴⁷¹ This further illustrates the inequity in Staff’s view that unrecovered rate case expense is forfeit. Surely
26 the Company coming back in for another rate case is preferable to the Company recovering 129% of its
authorized rates, absent an adjuster.

1 that phase-ins merely postpone recovery, under the totality of the circumstance, LPSCO
2 asserts that phased in rates are acceptable. Assuming, again, that LPSCO is actually made
3 whole.

4 RUCO has proposed a phase in of rates in its final schedules.⁴⁷² With one
5 exception, RUCO's phase-in has merit. RUCO'S proposed phase-in softens the initial
6 rate increase impact through use of a 50-percent first phase for six months, as opposed to
7 80 percent for one year under the Company's proposal. RUCO's phase-in also spreads
8 the recovery of the shortfall out over a longer period of time, further mitigating the
9 impacts of rate increases. Finally, by using a surcharge to collect revenue, RUCO's
10 proposal eliminates some of the uncertainty that arises at the end of the third year of the
11 Company's proposal, and would ensure that the Company collected no more and no less
12 than that required, making the Company whole. The only flaw in RUCO's proposal is
13 that RUCO does not make the Company whole because RUCO discontinues the carrying
14 cost after the first six months.⁴⁷³ But LPSCO would be carrying the cost of foregone
15 revenue until it has fully recovered that revenue; therefore, the carrying cost must be
16 calculated for the entire surcharge period.⁴⁷⁴

17 If the flaw in RUCO's phase-in model were corrected, the model could form the
18 basis for an alternative to the Company's proposed phase-in. Specifically, LPSCO would
19 also accept phased-in rates that provide for 60 percent of the increased revenue being
20 implemented in phase one for six months. This would further minimize the sudden
21 impact of rate increases relative to the Company's proposal. The Company would go
22 further than RUCO, however, and have a second phase at 80 percent for the second six

23

⁴⁷² RUCO Final Schedule 5 (water and wastewater).

24 ⁴⁷³ *Id.*

25 ⁴⁷⁴ RUCO witness Rigsby seemingly would agree given his testimony regarding the problems with the
26 involuntary phasing in of rate. Tr. at 981:7 – 982:2, 995:12 – 996:17. As Mr. Sorensen testified, LPSCO
will not accept a phase in unless it provides that the Company actually be made whole. *Id.* at 1379:4-6.

1 months, before the full rates would go into effect after one year. Further, the Company
2 would agree to collect the shortfall over longer than one year as it proposed, as long as it
3 is made completely whole within three years from the effective date of the decision.⁴⁷⁵
4 Finally, LPSCO would agree to collect the recovery through a surcharge, which appears
5 better suited to ensure the Company recovers exactly what it needs to be made whole, no
6 more and no less.

7 **VI. FINANCING APPLICATIONS**

8 The Company filed two separate financing applications that were consolidated into
9 this docket. The Company proposes to finance a solar energy project at its PVWRF and
10 an effluent recharge facility. These projects are to be funded with WIFA debt, however
11 WIFA requires prior Commission approval. The Company has specifically asked that any
12 Commission approval allow it the flexibility to choose the most appropriate recharge
13 technology, rather than being restricted to a particular methodology. LPSCO understands
14 that it will still be required to use the debt in the manner contemplated by Commission
15 and WIFA approvals. Provisions would also be made as needed for further Staff review
16 to ensure full compliance.

17 **CONCLUSION**

18 Based on the foregoing, LPSCO respectfully requests the following relief:

- 19 a. A finding that the fair value of LPSCO'S property devoted to water and
20 wastewater service is \$37,762,676 and \$28,222,289, respectively;
- 21 b. Approval of an overall rate of return on such rate base equal to 11.01
22 percent;
- 23 c. A determination of a revenue requirement for LPSCO's water and sewer
24 divisions of \$13,680,114, respectively, which constitute increases over adjusted test year

25 _____
26 ⁴⁷⁵ *Id.* at 1379:7-14.

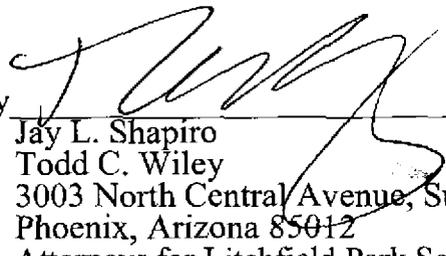
1 water revenues of \$6,801,405, or 98.88 percent, and \$4,805,020, or 75.59 percent, over
2 the test year;

3 d. Approval of rates designed to allow the Company to recover such revenue
4 requirement, including as appropriate, phased-in rates with provision to ensure that
5 LPSCO is actually made whole for any revenue shortfall realized during the phasing
6 period; and,

7 e. For approval of a low-income tariff and the other requested tariff changes,
8 along with such other and further relief as the Commission deems appropriate to
9 implement the relief requested herein.

10 RESPECTFULLY SUBMITTED this 10th day of February, 2010.

11 FENNEMORE CRAIG, P.C.

12
13
14 By 

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15
16
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18 of the foregoing were filed
19 this 10th day of February, 2010, with:

20 Docket Control
21 Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

22 **Copy of the foregoing was hand delivered**
23 this 10th day of February, 2010, with:

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Litchfield Park Service Company
Docket Nos. SW-01428A-09-0103, W-01427A-09-0104,
W-01427A-09-0116, W-01427A-09-0120

INITIAL CLOSING BRIEF
February 8, 2010

Brief Exhibit 1

COMPARISON OF LPSCO'S OPERATING COSTS TO OTHER ARIZONA WATER UTILITIES¹

	Az-Am (Anthem Water)	Johnson Utilities	H2O, Inc.	Chaparral City Water Co.	Arizona Water Co. (Eastern Group)	Arizona Water Co. (Supersession)	Arizona Water Co. (Western Group)	Global Water (Santa Cruz Water Co.)	Arizona Water Co. (Casa Grande)	Litchfield Park Service Company	Arizona Water Co. (Northern Group)	Average for All Utilities/Groups
	12/31/2007	12/31/2007	12/31/2006	12/31/2006	12/31/2007	12/31/2007	12/31/2007	12/31/2008	12/31/2007	9/30/2008	12/31/2007	11
Test Year Customers ²	8,703	17,541	5,843	13,500	33,635	20,946	29,725	15,371	22,455	15,594	19,631	--
Total Revenue	\$9,357,346	\$13,744,459	\$3,383,145	\$7,446,700	\$19,912,250	\$11,939,904	\$14,997,500	\$9,110,720	\$10,934,895	\$6,475,002	\$9,351,854	--
Total Expenses	\$7,215,051	\$11,055,456	\$3,026,826	\$6,649,429	\$16,418,219	\$10,089,501	\$13,915,349	\$7,141,309	\$10,277,900	\$6,757,896	\$8,010,110	--
Salary/Wages	\$801,914	--	\$790,693	\$969,244	--	--	--	\$781,051	--	--	--	--
Pension/Benefits	--	--	--	--	--	--	--	\$189,983	--	--	--	--
Purchased Water	\$444,337	\$334,948	\$77,793	\$821,656	\$1,281,014	\$1,019,696	\$683,543	\$374,207	\$374,207	\$5,011	\$1,291	--
Purchased Power	\$965,412	\$828,905	\$253,894	\$602,982	\$2,011,545	\$1,170,704	\$1,709,936	\$534,361	\$1,387,878	\$1,013,811	\$900,192	--
Chemicals	\$90,637	\$16,189	\$4,229	\$127,457	\$512,526	\$389,035	\$668,394	\$40,139	\$531,617	\$503,278	\$593,531	--
Repairs/Maint.	--	\$14,333	\$199,694	\$104,609	--	--	--	--	--	\$44,001	--	--
Materials/Supp.	\$64,824	\$1,119	\$236,896	\$19,800	--	--	--	\$316,002	--	--	--	--
Cont.Serv. Test.	--	\$53,007	\$12,289	\$43,458	\$1,702,216	\$945,427	\$1,287,088	\$36,113	\$909,384	\$28,365	\$1,000,938	--
Cont. Accounting	--	\$5,877,591	--	--	\$1,839,922	\$1,591,413	\$2,359,829	--	1,761,682	\$2,395,445	\$1,789,727	--
Admin/General	\$1,132,699	--	--	--	--	--	--	--	--	--	--	--
Manage. Fees	\$14,739	\$53,444	\$212,418	\$70,430	--	--	--	\$94,369	--	\$10,647	--	--
Rent	--	\$182,654	\$182,654	\$70,430	--	--	--	\$45,296	--	\$151,879	--	--
Transportation	\$240,221	\$21,565	\$46,695	(\$1,294)	--	--	--	\$53,083	--	\$93,469	--	--
Insurance-GL	\$61,231	--	\$61,213	--	--	--	--	\$4,647	--	\$3,319	--	--
Insurance-Other	\$270,744	\$286,747	\$7,244	\$1,259,948	--	--	--	\$34,629	--	\$81,665	--	--
Misc.	\$1,979,383	\$1,548,515	\$343,359	\$1,608,019	\$3,280,223	\$2,169,209	\$3,147,532	\$3,507,185	\$2,329,760	\$2,291,982	\$1,619,823	--
Depreciation	\$74,690	\$1,186,292	\$221,095	\$270,030	\$1,161,460	\$1,562,763	(\$531,079)	\$1,238,040	(\$549,126)	(\$449,717)	\$79,951	--
Income Taxes	\$414,503	\$797,488	\$201,549	\$295,813	\$1,250,728	\$815,562	\$1,851,878	\$806,467	\$373,354	\$373,354	\$716,221	--
Property Taxes	\$69,970	\$63,002	\$63,002	\$47,783	\$229,212	\$137,164	\$334,713	\$6,823	\$219,346	--	\$131,494	--
Other Taxes	\$829,03 (1)	\$630,26 (2)	\$518,03 (3)	\$492,55 (4)	\$488,13 (5)	\$481,69 (6)	\$468,14 (7)	\$464,60 (8)	\$457,71 (9)	\$433,37 (10)	\$408,03 (11)	\$515.59 (LPSCO \$433.37)
Cost/Customer	\$4,676,365	\$7,523,181	\$2,197,821	\$4,427,794	\$11,498,596	\$6,817,003	\$9,912,305	\$2,389,261	\$7,471,653	\$4,542,277	\$5,802,621	--
Total Expenses - Taxes/Deprec.	\$557,33 (1)	\$428,90 (2)	\$376,15 (3)	\$373,98 (7)	\$341,80 (4)	\$325,46 (8)	\$333,47 (5)	\$155,44 (11)	\$332,74 (6)	\$291,28 (10)	\$295,58 (9)	\$340.56 (LPSCO \$291.28)
Taxes/Deprec.	\$3,173,379	\$6,343,139	\$1,861,905	\$2,863,699	\$7,711,511	\$4,237,568	\$6,850,432	\$1,794,761	\$5,177,951	\$3,020,177	\$4,302,607	--
Total Exp. - Tax/Dep./Pow/Chem	\$3,643,93 (1)	\$3,616,62 (2)	\$318,66 (3)	\$2,122,27 (8)	\$2,292,27 (6)	\$2,021 (9)	\$2,304,65 (5)	\$1,167,76 (11)	\$2,305,94 (4)	\$1,936,68 (10)	\$2,191,17 (7)	\$244.01 (LPSCO \$193.68)
Cost/Cust. - Tax/Dep./Pow/Chem	\$3,643,93 (1)	\$3,616,62 (2)	\$318,66 (3)	\$2,122,27 (8)	\$2,292,27 (6)	\$2,021 (9)	\$2,304,65 (5)	\$1,167,76 (11)	\$2,305,94 (4)	\$1,936,68 (10)	\$2,191,17 (7)	\$244.01 (LPSCO \$193.68)

¹ The numbers on this chart are based on each company's Adjusted Test Year figures contained in the company's C-1 Schedule filed in each company's recent rate case. This chart compares the operating costs of LPSCO to various comparably sized Arizona water utilities. The Arizona Water Company divisions, Johnson Utilities and H2O Inc. are stand-alone water utilities. The Arizona-American divisions, Global Water—Santa Cruz Water Company and Chaparral City Water Company are part of affiliate holding company structures.

² The customer numbers are based on each company's H-2 Schedule filed in each company's most recent rate case.

³ This row equals Total Operating Expenses divided by the total number of customers.

⁴ This row equals Total Operating Expenses minus Taxes and Depreciation divided by the total number of customers.

⁵ This row equals Total Operating Expenses minus Taxes, Depreciation, Purchased Power, and Chemicals divided by the total number of customers.

COMPARISON OF LPSCO'S OPERATING COSTS TO OTHER ARIZONA SEWER COMPANIES¹

Test Year	Az-Am (Anthem-Agua Fria) 12/31/2008	Az-Am (Anthem) 12/31/2007	Az-Am (Mohave Wastewater) 12/31/2007	Coronado Utilities 12/31/2008	Johnson Utilities 12/31/2007	Lifebfield Park Service Co. 9/30/2008	Global Water (Palo Verde) 12/31/2008	Far West 12/31/2007	Average for All 8 Utilities
Total Revenue	13,038	8,456	796,161	1,281	21,596	14,589	15,152	7,237	
Total Expenses	\$8,637,123	\$6,395,183	\$780,542	\$883,530	\$11,288,663	\$6,356,372	\$6,376,014	\$2,139,964	
Salary/Wages (601)	\$8,828,909	\$5,438,217	\$108,996	\$729,033	\$10,696,172	\$1,205	\$924,853	\$2,999,582	
Pension/Benefits (604)	\$1,335,278	\$439,668	--	\$52,500	\$32,762	\$632,064	\$215,792	\$870,122	
Purchased Water (610)	--	--	--	--	--	\$79,249	--	--	
Chemicals (615)	\$3,368	\$352,338	--	\$3,676	--	\$75,579	\$595,128	--	
Materials/Supplies (620/620.08)	\$278,664	\$101,456	\$73,650	\$54,218	--	\$33,348	\$157,174	--	
Contract Services- Testing (635)	\$303,374	\$49,707	\$9,214	\$27,790	--	\$18,976	\$558,602	--	
Contract Services Other (636)	\$85,697	--	\$7,874	\$2,978	--	\$99,923	\$47,418	--	
Rent (641)	--	--	--	--	--	\$2,716,001	\$183,263	\$158,510	
Management fees	--	--	--	--	\$4,826,240	--	--	--	
Transportation (650)	\$84,483	--	\$1,613	\$182,727	--	--	--	--	
Insurance-GL (657)	\$1,528,005	\$890,005	\$123,665	\$209,000	\$48,151	\$2,716,001	\$183,263	\$107,425	
Misc. (675)	\$396,599	\$90,870	\$24,046	\$37,081	--	\$18,976	\$91,111	--	
Depreciation (403)	\$94,566	\$90,870	\$2,294	\$186,095	--	\$69,551	\$32,133	--	
Income Taxes	\$534,489	\$49,453	\$7,294	\$7,111	--	\$32,133	\$35,559	--	
Property Taxes	\$3,830,808	\$259,385	\$24,046	\$3,142,068	\$231,593	\$2,213	\$52,375	\$199,706	
Other Taxes	\$1,020,813	\$1,988,462	\$16,726	\$785,281	\$36,056	\$36,056	\$4,320	\$63,570	
Cost/Customer ²	\$296,804	\$175,361	\$248,398	\$785,281	\$1,550,237	\$56,965	\$38,805	\$38,805	
	\$87,338	\$512,237	\$569,111 (4)	\$6,525	(\$100,258)	\$31,572,85	\$34,270	--	
	\$677,17 (1)	\$36,892	\$480,395	\$495,28 (5)	\$336,799	\$89,555	\$34,270	--	
Total Expenses - Taxes/Deprec. Cost/Cust. Less	\$5,634,572	\$643,12 (2)	\$454,52 (1)	\$6,431,776	\$424,46 (6)	\$18,976	\$1,550,751	\$343,09	
Taxes/Deprec. Cost/Cust. Less	\$432,17 (2)	\$2,725,265	\$375,02 (3)	\$297,82 (7)	\$301,98 (6)	\$206,12 (8)	\$2,076,237	\$343,09	
Total Expenses-Tax/ Dep./Pow./Chem Cost/Cust. Less Tax/ Dep./Power/Chem ⁵	\$5,049,166	\$322,29 (5)	\$398,387	\$5,596,023	\$3,492,617	\$2,370,802	\$286,89 (4)	\$286,89	
	\$387,27 (2)	\$2,271,471	\$310,10 (3)	\$259,12 (6)	\$156,47 (8)	\$156,47 (8)	\$286,89 (4)	\$286,89	
	\$268,62 (5)	\$478,474	\$375,02 (3)	\$5,596,023	\$3,492,617	\$2,370,802	\$286,89 (4)	\$286,89	
		\$387,43 (1)	\$310,10 (3)	\$259,12 (6)	\$156,47 (8)	\$156,47 (8)	\$286,89 (4)	\$286,89	

¹ The numbers on this chart are based on each company's Adjusted Test Year figures contained in the company's C-1 Schedule filed in each company's recent rate case.
² The customer numbers are based on each company's H-2 Schedule filed in each company's most recent rate case.
³ This row equals Total Operating Expenses divided by the total number of customers.
⁴ This row equals Total Operating Expenses minus Taxes and Depreciation divided by the total number of customers.
⁵ This row equals Total Operating Expenses minus Taxes, Depreciation, Purchased Power, Purchased Water and Chemicals divided by the total number of customers.

WATER COMPANIES

COMPANY NAME	ACC DOCKET NO.
Arizona-American Water Company, Anthem Water District	W-01303A-09-0343 (consolidated with SW-01303A-09-0343)
Johnson Utilities	WS-02987A-08-0180
Chaparral City Water Company	W-02113A-07-0551
Arizona Water Company (Eastern Group)	W-01445A-08-0440
Arizona Water Company (Superstition)	W-01445A-08-0440
H2O, Inc.	W-02234A-07-0557
Arizona Water Company (Western Group)	W-01445A-08-0440
Global Water (Santa Cruz Water Co.)	W-20446A-09-0080 (consolidated with SW-20445A-09-0077, W-02451A-09-0078, W-01732A-09-0079, W-02450A-09-0081, and W-01212A-09-0082)
Arizona Water Company (Casa Grande)	W-01445A-08-0440
Litchfield Park Service Company	W-01427A-09-0104 (consolidated with SW-01428-09-0103, W-01427A-09-0116, and W-01427A09-0120)
Arizona Water Company (Northern Group)	W-01445A-08-0440

SEWER COMPANIES

COMPANY NAME	ACC DOCKET NO.
Arizona-American Water Company, Anthem-Agua Fria Wastewater District	SW-01303A-09-0343 (consolidated with W-01303A-09-0343)
Arizona-American Water Company, Anthem Wastewater District	SW-01303A-08-0227 (consolidated with W-01303A-08-0227)
Arizona-American Water Company, Mohave Wastewater District	SW-01303A-08-0227 (consolidated with W-01303A-08-0227)
Coronado Utilities	SW-04305A-09-0291
Johnson Utilities	WS-02987A-08-0180
Litchfield Park Service Company	SW-01428-09-0103 (consolidated with W-01427A-09-0104, W-01427A-09-0116, W-01427A09-0120)
Global Water – Palo Verde Utilities Company	SW-03575A-09-0077
Far West Water & Sewer	WS-03478-08-0454