

ORIGINAL

OPEN MEETING ITEM



0000105602

Executive Director

02

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



ARIZONA CORPORATION COMMISSION

DATE: DECEMBER 2, 2009

DOCKET NO.: W-02069A-08-0406

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Sarah N. Harpring. The recommendation has been filed in the form of an Opinion and Order on:

SUNRISE WATER CO.
(RATES)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00** p.m. on or before:

DECEMBER 11, 2009

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

DECEMBER 15, 2009 and DECEMBER 16, 2009

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602)542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

RECEIVED

2009 DEC -2 P 2: 16

AZ CORP COMMISSION
DOCKET CONTROL

Arizona Corporation Commission
DOCKETED

DEC - 2 2009

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DOCKETED BY

1200 WEST WASHINGTON STREET; PHOENIX, ARIZONA 85007-2927 / 400 WEST CONGRESS STREET; TUCSON, ARIZONA 85701-1347

www.azcc.gov

This document is available in alternative formats by contacting Shaylin Bernal, ADA Coordinator, voice phone number 602-542-3931, E-mail SABernal@azcc.gov

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF
SUNRISE WATER CO. FOR A DETERMINATION
OF THE CURRENT FAIR VALUE OF ITS
UTILITY PROPERTY AND FOR AN INCREASE
IN ITS WATER RATES AND CHARGES FOR
UTILITY SERVICE.

DOCKET NO. W-02069A-08-0406

DECISION NO. _____

OPINION AND ORDER

DATES OF HEARING: May 8 (Pre-Hearing Conference), May 11, May 12, and June 26, 2009

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Dwight D. Nodes¹

APPEARANCES: Mr. Craig A. Marks, CRAIG A. MARKS, P.C., on behalf of Sunrise Water Co.; and

Mr. Wesley Van Cleve, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

This case involves an application for a permanent rate increase, filed with the Arizona Corporation Commission ("Commission") on August 1, 2008, by Sunrise Water Co. ("Sunrise"), a Class B water utility providing water utility service in northern Peoria, in Maricopa County, Arizona. Sunrise is an S corporation wholly owned by J.D. Campbell, who also wholly owns West End Water Company ("West End"), another S corporation water utility. Sunrise's last permanent rate case was decided in Decision No. 53721 (August 31, 1983).

* * * * *

Having considered the entire record herein and being fully advised in the premises, the

¹ Administrative Law Judge Dwight D. Nodes presided over all of the proceedings in this matter. The Recommended Opinion and Order was drafted by Administrative Law Judge Sarah N. Harpring.

1 Commission finds, concludes, and orders that:

2 **FINDINGS OF FACT**

3 **Background**

4 1. Sunrise is a Class B water utility providing water utility service to approximately 1,340
5 primarily residential customers,² as well as through 3" hydrant meters and a coin-operated standpipe,
6 in an approximately 3.9-square-mile service area located in northern Peoria,³ in Maricopa County,
7 Arizona. (Ex. A-2.) Sunrise has only two commercial customers and primarily serves single-family
8 residences located on lots ranging from approximately 0.4 acres to several acres in size. (Ex. A-2.)

9 2. Sunrise's last permanent rate case was decided in Decision No. 53721 (August 31,
10 1983). For metered customers, Sunrise imposes a monthly minimum charge plus a commodity rate of
11 \$2.85 per thousand gallons for all usage. Sunrise's current tariff does not include rates and charges for
12 3" meters or standpipes, although Sunrise currently provides service through both of these.⁴

13 3. The average and median monthly consumption of Sunrise's residential ¾" meter
14 customers is relatively high,⁵ with average monthly consumption at 17,782 gallons and median
15 monthly consumption at 13,476 gallons. (Ex. A-1.)

16 4. According to a Maricopa County Environmental Services Department ("MCESD")
17 Public Water System Compliance Report issued June 13, 2008, and included with Sunrise's
18 application, Sunrise is in substantial compliance with MCESD requirements and, as of an inspection
19

20 ² At the end of the TY, Sunrise had 1,315 residential customers, 2 commercial customers, and 7 hydrant customers.
(Ex. S-2.) As of May 2009, Sunrise had 1,340 customers. (Tr. at 41.)

21 ³ Sunrise's service area is bounded by 99th Avenue to the west, Happy Valley Road to the north, 75th Avenue to the east,
and Williams Road to the south. (Ex. A-2.)

22 ⁴ Official notice is taken of Sunrise's current tariff on file with the Commission. Sunrise's current tariff includes a
23 monthly minimum charge for 1 ½" meters, although no rate for these was authorized in Decision No. 53721. Sunrise's
24 tariff states that the 1 ½" meter rate was approved pursuant to A.R.S. § 40-367 on November 18, 1999, to become effective
with November 19, 1999 usage. Sunrise's tariff does not include any meter installation charges, although such charges
25 were approved in Decision No. 53721. Sunrise's current tariff includes service charges that were not included in Decision
No. 53721 and indicates that those charges were authorized in Decision No. 53162 (August 11, 1982). It appears that one
26 of the additional service charges in Sunrise's current tariff, the minimum deposit for a nonresidential customer, exceeds the
amount authorized in Decision No. 53162, although it conforms to the maximum deposit permitted by A.A.C. R14-2-
403(B)(7)(b). In addition, no charge for moving a customer meter was included in Decision No. 53162, although such a
27 charge is included in Sunrise's tariff; Sunrise's tariff indicates that its after-hours service charge is an hourly rate, which
was not indicated in Decision No. 53162; and Sunrise's tariff omits two service charges authorized in Decision No. 53162.
It is unclear why these discrepancies exist.

28 ⁵ The average monthly consumption of Sunrise's residential 1", 1 ½", and 2" meter customers is also rather high, at
26,737 gallons, 33,487 gallons, and 178,604 gallons, respectively. (Ex. A-1.)

1 on April 27, 2007, had no noted treatment plant deficiencies and only minor operation and
2 maintenance deficiencies resulting from a need to install a well sign, remove trees and shrubs, address
3 rust on a tank, install a lock, perform general cleanup, and install splash blocks under drains.⁶ Sunrise
4 further included an August 3, 2007, letter to MCESD stating that the minor operation and maintenance
5 deficiencies had been remedied. Sunrise is delivering water that complies with state and federal
6 drinking water quality standards as required by Arizona Administrative Code ("A.A.C.") Title 18,
7 Chapter 4. (Ex. S-1.)

8 5. Sunrise is located in the Phoenix Active Management Area ("AMA") and is subject to
9 AMA reporting and conservation requirements. (Ex. S-1.) According to an Arizona Department of
10 Water Resources ("ADWR") Compliance Status Report received by Staff in October 2008, Sunrise is
11 currently in compliance with ADWR requirements governing water providers and/or community
12 water systems. (*Id.*)

13 6. Sunrise's system has seven wells, five of which are active,⁷ and seven storage tanks
14 with a combined capacity of 1,231,000 gallons. (Ex. S-1.) Staff determined that Sunrise's system has
15 adequate well production and storage capacity to serve its existing connections and reasonable growth.
16 (*Id.*) Staff projects that Sunrise could have approximately 1,370 customers by the end of 2012. (*Id.*)

17 7. Sunrise is subject to mandatory participation in the ADEQ Monitoring Assistance
18 Program ("MAP"), which requires water companies to pay a fixed \$250 per year fee plus an additional
19 fee of \$2.57 per service connection in sampling fees. (Ex. S-1.)

20 8. During the TY, Sunrise pumped 414.41 million gallons of water and sold 393.70
21 million gallons, which reflects a water loss of approximately 5 percent, well within Commission
22 standards. (Ex. S-1.)

23 9. Staff's Compliance Section reported that Sunrise has no delinquent compliance items.
24 (Ex. S-1.)

25
26 ⁶ Official notice is taken of this MCESD Compliance Status Report and of the August 3, 2007, letter from Sunrise to
MCESD, both of which were included in the application, but neither of which was included as an Exhibit.

27 ⁷ Well Number 2 has been out of service since January 2006 because its arsenic level, at 37 parts per billion ("ppb")
28 exceeds the current U.S. Environmental Protection Agency ("EPA") and Arizona Department of Environmental Quality
("ADEQ") arsenic maximum contaminant level ("MCL") of 10 ppb. (Ex. S-1.) Well Number 1 has been used as an
observation well since 1985. (*Id.*)

1 10. The Commission's Consumer Service database shows that Sunrise was the subject of
2 four complaints between 2005 and 2007, two related to new service and two related to billing. (Ex. S-
3 2.) Sunrise was not the subject of any complaints in 2008 or from January 1 through February 27,
4 2009. (*Id.*)

5 11. Staff reported that Sunrise is in good standing with the Commission's Corporations
6 Division. (Ex. S-2.)

7 12. Staff reported that Sunrise's bill format complies with Commission rule A.A.C. R14-2-
8 409(B)(2). (Ex. S-2.)

9 13. Sunrise has a curtailment plan tariff on file with the Commission. (Ex. S-1.)

10 14. Sunrise has a cross-connection/backflow prevention tariff on file with the Commission.
11 (Ex. S-2.)

12 **Procedural History**

13 15. On August 1, 2008, Sunrise filed with the Commission an application using a test year
14 ("TY") ending December 31, 2007, and requesting a rate increase of \$285,932, or approximately 22
15 percent, over unaudited adjusted TY gross revenues of \$1,304,363. (Ex. A-1.) Sunrise showed that it
16 had operated at a loss during the TY and proposed increased rates to allow it to earn a return on its
17 original cost rate base ("OCRB"). (Ex. A-5.) In addition, Sunrise proposed adoption of tiered
18 commodity rates to replace its current single commodity rate for all usage, to increase conservation.
19 (*Id.*) With its application, Sunrise filed the Direct Testimony of Marvin E. Collins, Sunrise's
20 Manager, and Ray L. Jones, Consultant, ARICOR Water Solutions. Sunrise asserts that significant
21 construction projects completed during the TY to comply with federal arsenic levels, together with
22 increased expenses and regulatory requirements, necessitate a rate increase. (Ex. A-5.)

23 16. On September 2, 2008, the Commission's Utilities Division ("Staff") issued a
24 Sufficiency Letter.

25 17. On September 8, 2008, a Procedural Order was issued scheduling a pre-hearing
26 conference in this matter for May 8, 2009; scheduling a hearing for May 11, 2009; and establishing
27 other procedural requirements and deadlines.

28 18. On September 16, 2008, Sunrise filed revised rate design and hydrant meter data

1 schedules.

2 19. On October 7, 2008, Sunrise filed a Motion to Revise Customer Notice, asking that two
3 figures in the required notice be amended. The Motion was granted by a Procedural Order issued on
4 October 22, 2008.

5 20. On November 17, 2008, Sunrise filed an Affidavit of Customer Notice showing that
6 public notice had been sent to Sunrise's customers on November 14, 2008, and an Affidavit of
7 Publication showing that the public notice had been published in the *Peoria Times*, a newspaper of
8 general circulation within and around its service area, on November 14, 2008. (Ex. S-2.)

9 21. Jian W. Liu, Staff Utilities Engineer, inspected the water system on December 19,
10 2008. (Ex. S-1.)

11 22. On February 27, 2009, Staff filed the Direct Testimony of Alexander I. Igwe, CPA,
12 Staff Executive Consultant III, and Mr. Liu.

13 23. On March 27, 2009, Sunrise filed the Rebuttal Testimony of Mr. Collins and Mr. Jones.

14 24. On April 17, 2009, Staff filed the Surrebuttal Testimony of Mr. Igwe.

15 25. On May 1, 2009, Sunrise filed the Rejoinder Testimony of Mr. Collins and Mr. Jones.

16 26. On May 5, 2009, Sunrise filed summaries of the testimony of Mr. Collins and Mr.
17 Jones.

18 27. On May 7, 2009, Staff filed summaries of the testimony of Mr. Igwe and Mr. Liu.

19 28. On May 8, 2009, the pre-hearing conference was held at the Commission's offices in
20 Phoenix, Arizona. Sunrise and Staff appeared through counsel and jointly provided a matrix of the
21 contested issues in this matter.

22 29. On May 11 and 12, 2009, an evidentiary hearing in this matter was held at the
23 Commission's offices in Phoenix, Arizona. Sunrise and Staff appeared through counsel. Testimony
24 for Sunrise was received from Mr. Collins and Mr. Jones, and testimony for Staff was received from
25 Mr. Liu and Mr. Igwe. During the hearing, the issue of recovery of income tax expense was discussed
26 at length, and it was determined that additional testimony related to the income tax expense issue
27 would be filed by June 22, 2009, and that additional hearing regarding the issue would take place on
28 June 26, 2009.

1 30. On June 22, 2009, Sunrise filed the Supplemental Testimony of Mr. Jones, and Staff
2 filed the Supplemental Testimony of Mr. Igwe.

3 31. On June 26, 2009, the evidentiary hearing in this matter reconvened at the
4 Commission's offices in Phoenix, Arizona. Sunrise and Staff appeared through counsel. Testimony
5 for Sunrise was received from Mr. Jones, and testimony for Staff was received from Mr. Igwe. At the
6 conclusion of the hearing, it was determined that initial closing briefs and reply briefs would be filed
7 by July 24 and August 7, 2009, respectively.⁸

8 32. On July 24, 2009, Sunrise filed its Post-Hearing Brief, and Staff filed its Closing Brief.

9 33. On August 7, 2009, Sunrise and Staff filed their Reply Briefs.

10 **Ratemaking**

11 34. Sunrise is an S corporation wholly owned by J.D. Campbell, its President, (Ex. S-2),
12 who also wholly owns and serves as the President of West End, another S corporation, (Decision No.
13 68925 (August 29, 2006)). Sunrise, West End, and J.D. Realty, Inc.⁹ ("JDR") are jointly managed
14 from shared corporate offices located in Peoria, Arizona. (Ex. S-2.) Some elements of the three
15 companies' operating costs are initially booked to Sunrise and then subsequently allocated to the other
16 companies, which Staff characterized as "significant commingling of operating costs in Sunrise's
17 accounting system." (Ex. S-2.) Mr. Igwe has informed both Mr. Collins and Sunrise's controller that
18 there needs to be separation of records and of transactions for Sunrise and West End. (Tr. at 257.)

19 35. Sunrise has 10 employees, including its President, a Manager, a field operations
20 supervisor,¹⁰ a controller, a customer service representative, an accounts payable clerk, two full-time
21 field laborers, a part-time field laborer, and a receptionist. (Ex. A-2.) As the Manager, Mr. Collins is
22 responsible for the day-to-day operations of the water company; to ensure that water service is
23 maintained; to ensure that Sunrise complies with all of the regulatory requirements of the
24 Commission, ADWR, ADEQ, and the Maricopa County Health Department; to review and discuss
25 operations with field personnel; and to work with developers on new construction projects and

26 ⁸ At the conclusion of the hearing, the parties also acknowledged that they were aware that the Recommended Opinion
27 and Order in this matter would not be issued by the original deadline of August 28, 2009.

⁹ Mr. Campbell has been involved in the development of some of Sunrise's service area. (Tr. at 55.)

28 ¹⁰ Sunrise's field personnel do most of the maintenance for the company in house, repairing leaks and main breaks,
maintaining equipment, and repairing some equipment. (Tr. at 69.) Sunrise contracts out any new construction. (*Id.*)

1 requests for water service. (Tr. at 37.) Sunrise shares its employees with West End.¹¹ (Ex. A-5.) Ten
2 percent of the controller's salary is charged to entities other than Sunrise or West End, but the
3 remaining employees only work for the two water companies. (Tr. at 42.) Sunrise and West End do
4 not track the time office employees spend on one utility or the other, instead employing a three- or
5 four-factor method to allocate salaries based on customers, plant balances, and possibly revenues. (Tr.
6 at 117.) It is unclear whether field employee time is tracked for each utility. (*Id.*) Staff did not see
7 any specific records, such as time sheets, tracking the amount of time the shared employees spend
8 working for each business entity. (Tr. at 258.) Staff believes, however, that Sunrise's various
9 personnel are necessary for provision of service and did not find any evidence of the employees' being
10 used for non-regulated business ventures. (Tr. at 254-56.)

11 36. During the TY, Mr. Campbell drew a salary of \$125,000 (not including taxes) as the
12 President of Sunrise. (Ex. A-1.) Post-TY, Mr. Campbell's salary was increased to \$129,500, which
13 represents an expense of \$137,826 when taxes are included.¹² (*Id.*) According to Mr. Collins, in his
14 capacity as President, Mr. Campbell acts as the chief financial officer; reviews all expenses and
15 finances and the capital needs of the company; reviews and signs all of the line extension agreements,
16 contracts, and development agreements of the company; reviews operations; meets regularly with
17 other personnel to discuss operations; and works within the community with customers and with local
18 governments. (Tr. at 38.) Mr. Jones differentiated Mr. Campbell's salary, which is paid for services
19 rendered on behalf of Sunrise, and Sunrise's rate of return, which is a return on investments made on
20 behalf of Sunrise. (Tr. at 112.) Mr. Jones acknowledged that there is the potential for self dealing
21 regarding the salary paid to Mr. Campbell and that it is an area that should be scrutinized by the
22 Commission, although he opined that it is not much different than a larger company that has
23 relationships with affiliates controlled by common officers or common boards, in which circumstances
24 the Commission evaluates expense levels and makes adjustments where appropriate. (Tr. at 112-13.)
25 Sunrise agreed to Staff's allocation of \$68,913 for Mr. Campbell's salary, approximately half of his
26 reported TY salary expense. (Tr. at 38; Ex. S-2.)

27 ¹¹ In the application, salary and wage expenses were charged based on the percentage of time each employee charges to
each company. (Ex. A-5.)

28 ¹² Most of Sunrise's employees received pay increases either during or post-TY or both. (Ex. A-1.)

1 37. Mr. Campbell leases office space, vehicles, and other facilities to Sunrise. (Ex. S-2.)
2 Mr. Collins testified that one of the storage areas is used by entities other than the water company, but
3 that the other storage area, the workshop, and the field office are used strictly for water company
4 operations. (Tr. at 42.) Mr. Collins is not aware of any lease agreement regarding the rented facilities
5 and believes that the lease amount was determined by taking the value allowed for the facilities in the
6 last Sunrise rate case and automatically adjusting it each year based on inflation. (Tr. at 43-44.) Mr.
7 Collins did not compare rental costs for comparable facilities to determine whether the expenses
8 claimed reflect competitive market rates for the rental of these facilities because he was not able to
9 identify any facilities in Sunrise's service area to use in the comparison. (Tr. at 49-50.) Mr. Collins
10 explained that the service area is primarily residential, with no industrial area and only one or two
11 commercial areas. (Tr. at 50.)

12 38. The vehicles leased to Sunrise are owned by Mr. Campbell, who purchased them
13 outright and leases them to Sunrise at what Mr. Jones characterized as a "fair market lease rate." (Tr.
14 at 126-27.) Mr. Jones agreed that, if it is possible for Sunrise to obtain vehicle leases itself directly,
15 Sunrise should consider doing that in the future. (Tr. at 127.)

16 39. In its application, Sunrise stated that its TY revenue was \$1,304,363; that its adjusted
17 TY operating revenue was (\$60,264); that it requires operating income of \$144,815; that it requires a
18 10-percent rate of return; that its operating income deficiency is \$205,079; that its gross revenue
19 conversion factor is 1.3942; and that it requires an increase in gross revenue of \$285,932. (Ex. A-1;
20 Ex. A-5.) In addition, Sunrise requested a number of pro forma adjustments to account for what it
21 characterized as known and measurable changes to rate base, expenses, and revenues and to create a
22 "normalized and realistic relationship" between rate base, expenses, and revenues. (Ex. A-5.) In its
23 application, Sunrise asserted that its original cost rate base ("OCRB") was \$1,448,154 and did not
24 request use of reconstruction cost new rate base ("RCNRB") to determine its fair value rate base
25 ("FVRB"). (Ex. A-1.)

26 40. Mr. Jones testified that Sunrise is requesting a rate increase because of increased
27 investments on a per-customer or per-gallon-delivered basis as a result of addressing its arsenic
28 problem, at a cost to Sunrise of approximately \$500,000; increased regulatory requirements, such as

1 the requirement for all new projects to have fire flow available;¹³ increased expenses, such as for
 2 electricity; and increased customers due to the growth bubble that occurred in its service area, which
 3 required investment to keep up. (Tr. at 128-29.) Mr. Jones acknowledged that Sunrise is now
 4 enjoying the increase in revenues that came with its new customers and stated that the growth bubble
 5 wound down by the end of 2008. (Tr. at 136-37.)

6 41. Staff and Sunrise agreed to include two post-TY projects related to arsenic remediation
 7 in Sunrise's rate base—a water main at 91st Avenue and Pinnacle Peak Road and a water main at 83rd
 8 Avenue and Avenida Del Sol. (Ex. S-1.) Staff determined that both water mains were installed to
 9 facilitate compliance with the EPA's maximum contaminant level ("MCL") for arsenic, because the
 10 installation of the two water mains made it possible to take Well #2, which provides water with
 11 arsenic levels significantly exceeding the MCL, out of service. (Ex. S-1.) During a Staff field
 12 inspection, Mr. Liu verified that the plant additions had been constructed and placed into service. (*Id.*)
 13 Mr. Liu testified that it is appropriate to include these post-TY plant additions because they are used
 14 and useful and benefit ratepayers. (Tr. at 143.) We find that it is appropriate to include these post-TY
 15 plant additions in Sunrise's FVRB, for the reasons stated by Staff.

16 42. Sunrise accepted numerous Staff-recommended adjustments to operating expenses,
 17 including Staff's recommendations to disallow approximately 50 percent of Mr. Campbell's annual
 18 salary; to disallow 50 percent of \$8,485 in incentive compensation; to reclassify the allowed amount
 19 of incentive compensation (bonuses) under salaries and wages;¹⁴ to reclassify \$1,500 in Arrowhead
 20 Mini Storage facility rent as a rent expense rather than an office supplies expense; to increase water
 21 testing expense by \$2,184 to conform to Staff's estimated cost of participating in MAP; to reclassify
 22 \$19,521 in corporate offices lease cost from miscellaneous expense to rent expense;¹⁵ to disallow
 23 \$3,507 in vehicle lease expense because Staff determined the TY lease payments made to Mr.
 24 Campbell for two of three trucks exceeded market rates; to disallow \$6,300 in bonding fees as a
 25 transportation expense; to disallow \$2,285 spent on flowers and retirement parties as a miscellaneous

26 ¹³ Mr. Jones testified that this is a fire code requirement imposed by the City of Peoria when approving a subdivision in
 27 the service area. (Tr. at 135.)

¹⁴ The \$8,485 amount had been misclassified under transportation expense, under gas and oil. (Ex. S-2.)

28 ¹⁵ Mr. Igwe testified that the corporate office space expense is allocated to each company based on the square footage of
 the space occupied by the company, which Staff found to be appropriate. (*See* Tr. at 254.)

1 expense; to reverse Sunrise's (\$6,413) for preliminary investment in water supply as a miscellaneous
 2 expense; to reverse Sunrise's (\$50,216) in capitalized overhead¹⁶ as a miscellaneous expense; and to
 3 increase depreciation expense by \$10,210 to reflect Staff's calculation of depreciation using the
 4 depreciation rates proposed by Sunrise. (Ex. A-3.) We find that these adjustments, to which Sunrise
 5 and Staff have agreed, are reasonable, and we will adopt them.

6 43. Sunrise requested a return on common equity of 10 percent, derived by reviewing rate
 7 orders issued by the Commission during 2008, which Sunrise stated had an average equity return of
 8 10.3 percent. (Ex. A-5.) Because Sunrise's capital structure consists of 100 percent equity, Sunrise
 9 also requested a 10-percent cost of capital. (*Id.*) Mr. Jones testified that it would not be appropriate to
 10 adopt a hypothetical capital structure containing a percentage of lower cost debt because an all-equity
 11 capital structure can be appropriate for a relatively small utility such as Sunrise that obtains much of
 12 its investment in the form of refunds of advances in aid of construction ("AIAC") and that can have
 13 difficulty obtaining financing except for large projects. (Tr. at 118-20.)

14 44. Staff agrees that Sunrise should be permitted to earn a 10.0 percent rate of return. (Ex.
 15 S-3.)

16 45. Sunrise and Staff took the following final positions regarding rate base and revenue
 17 requirements:

	<u>Sunrise Proposed¹⁷</u>	<u>Staff Recommended¹⁸</u>
19 Adjusted OCRB	\$1,248,012	\$1,183,834
20 Adjusted Operating Income	(\$32,542)	\$37,287
21 Current Rate of Return	-2.61%	3.15%
22 Required Rate of Return	10.00%	10.00%
23 Required Operating Income	\$124,801	\$118,383
24 Operating Income Deficiency	\$157,344	\$81,096

24 ¹⁶ Sunrise had stated that the negative capitalized overhead was designed to normalize the administrative and general
 25 expenses charged to capital projects, which were unusually high in the TY. Staff stated that the appropriate treatment is to
 26 capitalize these overhead costs—management fees charged to developers for projects overseen by Sunrise on the
 27 developers' behalf—in the original cost for the projects. (Ex. S-2.) Staff determined that Sunrise had been erroneously
 booking its overhead costs related to advances in aid of construction ("AIAC") and contributions in aid of construction
 ("CIAC") to operating expenses and that the (\$50,216) needed to be eliminated from operating expenses because it had
 already been borne by developers, results in understating cost of service, and is not a normal recurring cost of service to
 ratepayers. (*Id.*)

28 ¹⁷ The source for this data is Ex. A-7.

¹⁸ The source for this data is Ex. S-3.

1	Gross Revenue Conversion Factor	1.4169	1.00
	Required Increase in Gross Rev.	\$222,943	\$81,096
2	Adjusted TY Revenue	\$1,304,363	\$1,318,743
	Proposed Annual Revenue	\$1,527,305	\$1,399,839
3	Required Increase in Gross Rev. (%)	17.09%	6.15%

4 46. Sunrise's current rates and charges, Sunrise's proposed rates and charges, and Staff's
5 recommended rates and charges are as follows:

6		Present Rates	Company Proposed Rates	Staff Recommended Rates
7	<u>MONTHLY USAGE CHARGE:</u>			
8	3/4" Meter	\$12.00	\$ 17.00	\$ 17.00
	1" Meter	16.50	28.33	28.33
9	1 1/2" Meter	21.50	56.65	56.65
	2" Meter	26.50	90.64	90.64
10	3" Hydrant Meter	N/T	181.28	181.28
11	Coin-operated Standpipe	N/T	N/A	N/A
12	<u>COMMODITY RATES (Per 1,000 Gallons):</u>			
13	<u>All Meter Sizes</u>			
14	All Usage	\$2.85		
15	<u>3/4" Meter</u>			
	From 1 to 4,000 Gallons		\$2.13	\$1.70
16	From 4,001 to 18,000 Gallons		2.90	N/A
	Over 18,000 Gallons		3.52	N/A
17	From 4,001 to 13,000 Gallons		N/A	\$2.47
18	Over 13,000 Gallons		N/A	3.09
19	<u>1" Meter</u>			
	From 1 to 27,000 Gallons		\$2.90	\$2.47
20	Over 27,000 Gallons		3.52	3.09
21	<u>1 1/2" Meter</u>			
	From 1 to 35,000 Gallons		\$2.90	\$2.47
22	Over 35,000 Gallons		3.52	3.09
23	<u>2" Meter</u>			
	From 1 to 65,000 Gallons		\$2.90	\$2.47
24	Over 65,000 Gallons		3.52	3.09
25	<u>3" Hydrant Meter</u>			
26	All Usage	N/T	\$2.90	\$2.47
27	<u>Coin-operated Standpipe</u>			
28	All Usage	N/T	\$2.90	\$2.47

SERVICE LINE AND METER INSTALLATION CHARGES:

(Refundable pursuant to A.A.C. R14-2-405)

	<u>Current</u>	<u>Company Proposed</u>			<u>Staff Recommended</u>		
	Total Charge	Service Line Charge	Meter Charge	Total Charge	Service Line Charge	Meter Charge	Total Charge
5/8" x 3/4" Meter	N/T	N/T	N/T	N/T	\$430.00	\$ 130.00	\$ 560.00
3/4" Meter	\$275.00	\$445.00	\$ 255.00	\$ 700.00	445.00	255.00	700.00
1" Meter	325.00	495.00	315.00	810.00	495.00	315.00	810.00
1-1/2" Meter	550.00	550.00	525.00	1,075.00	550.00	525.00	1,075.00
2" Turbine	800.00	830.00	1,045.00	1,875.00	830.00	1,045.00	1,875.00
2" Compound	N/T	830.00	1,890.00	2,720.00	830.00	1,890.00	2,720.00
3" Meter & Above	N/T	Cost	Cost	Cost	Cost	Cost	Cost

SERVICE CHARGES:

	<u>Current Charges</u>	<u>Company Proposed</u>	<u>Staff Recommended</u>
Establishment	\$10.00	\$35.00	\$25.00
Establishment (After Hours)	20.00	50.00	35.00
Reconnection (Delinquent)	10.00	35.00	15.00
Reconnection (Delinquent, After Hours)	20.00	50.00	25.00
Meter Test	5.00	30.00	25.00
Deposit Requirement: Residential Customer	2 times the average bill	2 times the average bill	*
Deposit Requirement: Non-Residential Customer	2 ½ times the average bill	2 ½ times the average bill	*
Deposit Interest	N/T	6.00%	6.00%
Re-establish within 12 months	\$80.00	**	**
NSF Check	N/T	\$30.00	\$35.00
Meter Re-Read	N/T	10.00	10.00
Deferred Payment, Per Month	N/T	1.50%	1.50%
Late Charge Per Month	N/T	1.50%	1.50%
Moving Customer Meter	Cost	Cost	N/T

PRIVATE FIRE SERVICE:

4" Fire Line Service	N/T	\$25.00	\$25.00
6" Fire Line Service	N/T	35.00	35.00
8" Fire Line Service	N/T	45.00	45.00

N/T No Tariff

* Per Commission Rule A.A.C. R14-2-403(B)

** Months off system x monthly minimum bill

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax, per Commission Rule A.A.C. R14-2-409(D)(5).

All items billed at cost shall include labor, materials, and parts and all applicable taxes.

1 **Contested Issues**

2 47. Although Sunrise and Staff were able to reach agreement on a number of issues, they
3 continue to disagree concerning (1) whether to increase Sunrise's rate base to reflect post-TY refunds
4 of AIAC; (2) how to normalize Sunrise's unusually high TY hydrant water sales; (3) whether to allow
5 outside services expense for a consulting firm that engages in lobbying activities; (4) whether to allow
6 rent expenses for Sunrise's use of facilities owned by J.D. Campbell; (5) whether to allow Sunrise to
7 recover \$90,000 in rate case expense over a three-year normalization period, as opposed to the
8 \$75,000 originally requested by Sunrise and agreed upon by Staff; (6) whether to allow Sunrise to
9 recover pro forma income-tax expenses although it is not a directly taxable entity; (7) whether to set
10 the break-over point to the third tier commodity rate for the 3/4" meter size at the average consumption
11 level or at a lower level; (8) whether to include meter and service-line installation charges for the 5/8"
12 x 3/4" meter size; and (9) whether to allow Sunrise to charge the same service charges as West End
13 charges.

14 **Post-TY Refunds of AIAC**

15 48. Sunrise proposes AIAC of \$6,320,530, which reflects recovery of \$64,178 in post-TY
16 AIAC refunds, 50 percent of its post-TY AIAC refund amount. (Ex. A-6.) Sunrise asserts that its
17 AIAC balance should be decreased to reflect the annual refund of AIAC required by its line extension
18 agreements, with a corresponding increase in rate base. (Ex. A-1; Ex. A-5.) Sunrise states that the
19 refunds were required to be made by August 31, 2008; were based on the revenue period of July 1,
20 2007, through June 30, 2008; are known and measurable; and represent a significant investment in
21 plant in service that should be included in Sunrise's rate base. (Ex. A-1; Ex. A-5.) Sunrise also stated
22 that it makes refunds of AIAC each year based on revenues for the 12-month period from July 1 of the
23 prior year through June 30 of the current year. (Ex. A-1.) Because the post-TY refund amount was
24 based on only six months of revenue received during the TY, Sunrise revised its original position
25 during this proceeding to propose recovery of 50 percent (rather than 100 percent) of the refund
26 amount. (Ex. A-6.) Sunrise asserts that it is appropriate for the Commission to allow the adjustment
27 to AIAC because the Commission allowed Arizona-American Water Company to include post-TY
28 refunds of AIAC in rate base for the Anthem Water District and Anthem/Agua Fria Wastewater

1 District in Docket No. WS-01303A-06-0403. (Ex. A-7.) While Mr. Jones agrees that AIAC is non-
2 invested capital, he asserts that AIAC is no longer non-invested capital once it is refunded. (Tr. at 78.)
3 Mr. Jones testified that this would be an allowed adjustment under the Commission's rules for rate
4 cases, which allow for pro forma adjustments to be made to better match the assets and expenses of a
5 company for ratemaking purposes. (Tr. at 79.) Mr. Jones further testified that because the AIAC
6 refund amount accrued during the TY and was known and payable, recognizing the refunds avoids a
7 mismatch and better matches the plant investment with the expenses at the end of the TY. (Tr. at 100-
8 01.)

9 49. Staff asserts that it is not aware of any Commission rule permitting reduction of TY
10 AIAC for forecasted refunds and that ratemaking in Arizona is based on a historic TY, which requires
11 matching of investments, revenues, and expenses at the end of the chosen TY. (Ex. S-2.) Staff stated
12 that Sunrise's proposed pro forma adjustment would contravene this fundamental principle of
13 ratemaking by creating a mismatch. (Ex. S-2.) Because AIAC is non-investor-provided capital,
14 which is treated as a reduction to rate base, Staff asserts that Sunrise's adjustment would result in an
15 understatement of AIAC and an overstatement of rate base, on which Sunrise's investor would earn a
16 rate of return, at the expense of Sunrise's ratepayers, although the increase in rate base does not derive
17 from invested capital. (*Id.*) Staff stated that this would result in an overstated revenue requirement
18 and would unduly result in higher rates for ratepayers. (*Id.*) Mr. Igwe testified that he is not aware of
19 the Commission's ever allowing reduction of TY AIAC balance by projected refunds of AIAC and,
20 further, that he did not have any evidence to support Sunrise's assertions that the refunds had accrued
21 during the TY. (Tr. at 152.) Mr. Igwe also pointed out that although Sunrise has requested a post-TY
22 adjustment for refunds of AIAC, it has not provided any information regarding any positive post-TY
23 modifications to AIAC, although its position may have changed post-TY through booking new AIAC
24 and changing its customer count. (Tr. at 153.) Staff recommends denial of the adjustment for post-
25 TY refunds of AIAC. (Tr. at 154.) Staff asserts that the situation involving Arizona-American was
26 very unique and that the Commission made an exception in that case because of the size of the AIAC
27 related to the development of Anthem. (*Id.*)

28 50. We agree with Staff that the post-TY AIAC refunds should not be permitted as an

1 increase to Sunrise's rate base in this rate case, as this pro forma adjustment would result in a higher
2 rate base for the TY and thus higher rates for ratepayers. Sunrise states that it makes refunds of AIAC
3 each year, and any refunds of AIAC that correspond to the TY are already reflected in Sunrise's rate
4 base. In addition, as noted by Mr. Igwe, Sunrise has not provided information to establish that it has
5 not had any post-TY positive adjustments of AIAC, which could offset its requested pro forma
6 adjustment. In addition, we note that because Sunrise was not required by the Commission to file its
7 ratemaking application or to use a particular TY, it had the opportunity to select its TY. In selecting
8 the 2007 TY, it effectively chose not to have any AIAC refunds to be made in 2008 included in its rate
9 base for this rate case.

10 Hydrant Water Sales

11 51. Sunrise sells water for use in construction of specific projects through fire hydrants on
12 which it installs hydrant meters. (Tr. at 21.) The hydrant water is generally drawn either directly into
13 a water truck or into a large tank from which water trucks are filled. (*Id.*) Occasionally, hydrant water
14 is sold to fill a swimming pool, but the majority is sold for construction purposes. (Tr. at 22.)

15 52. Sunrise experienced an unusually high level of hydrant water sales during the TY both
16 because the Maricopa County Flood Control District, in cooperation with the City of Peoria and the
17 Maricopa County Department of Transportation, engaged in a large regional construction project, the
18 83rd Avenue/Pinnacle Peak Road Drainage Improvement Project ("Pinnacle Peak Project")¹⁹ during
19 the TY, and because its service area experienced a development boom from 2005 through 2007. (Ex.
20 A-5.) Sunrise states that the Pinnacle Peak Project alone resulted in construction water use of more
21 than 13 million gallons during the TY, more than 50 percent of Sunrise's total TY hydrant water sales.
22 (*Id.*) Sunrise asserts that the TY hydrant water sales should be normalized by excluding the Pinnacle
23 Peak Project sales altogether and then reducing the sales to the historical five-year average level for
24 the period from 2003 through 2007. (Ex. A-7.) Sunrise also proposes to normalize its TY purchased

25
26 ¹⁹ Mr. Collins explained that the Pinnacle Peak Project is designed to provide 100-year protection to the area between
27 Calle Lejos and Deer Valley Roads and approximately 83rd to 87th Avenues and 10-year protection to the areas between
28 87th and 91st Avenues. (Ex. A-3.) The Pinnacle Peak Project involved construction of two detention basins, a 100-year
storm drain, and a 10-year storm drain along with installation of several miles of storm drain piping and associated
repaving of streets. (*Id.*) Mr. Collins asserted that the Pinnacle Peak Project was not representative of normal construction
within Sunrise's service area. (*Id.*)

1 power expense to make it consistent with its proposed normalized level of hydrant water sales. (Ex.
2 A-5.)

3 53. Sunrise asserts that the levels of hydrant water sales for the period from 2003 to 2005
4 are representative of normal levels of hydrant water sales for Sunrise. (Ex. A-6.) Sunrise
5 acknowledges that its hydrant water sales revenue increased significantly in 2006 and 2007, and also
6 increased in 2008, but asserts that the increases are not representative of expected sales on a going-
7 forward basis. (*Id.*) Sunrise's service area had another large construction project during 2008, the
8 Happy Valley Road Project.²⁰ (Ex. A-3.) Sunrise asserts that the Pinnacle Peak Project and Happy
9 Valley Road Project accounted for 52.3 percent of sales in 2007 and 77 percent of sales in 2008, but
10 had ceased by the end of 2008,²¹ and that hydrant water sales aside from these two projects (what Mr.
11 Collins refers to as "base" hydrant water sales) have since decreased dramatically. (*Id.*) Sunrise
12 believes that failure to normalize hydrant water sales as proposed by Sunrise will result in
13 overstatement of TY hydrant water sales. (*Id.*) Sunrise reports that its hydrant water sales for the
14 period from January 1 through March 20, 2009, were only 163,500 gallons, which Mr. Collins
15 attributes to the "near complete standstill" of development and construction activity within Sunrise's
16 service area due to the depressed housing market in the greater Phoenix area as well as the fact that
17 both the Pinnacle Peak Project and Happy Valley Road Project have concluded. (*Id.*) Sunrise projects
18 that its hydrant water sales in 2009 will be at or below 2003 levels. (*Id.*) Sunrise asserts that without
19 its proposed normalization adjustment, TY revenues would not represent revenues on a going-forward
20 basis and would create a mismatch between revenue and rate base. (*Id.*) Mr. Collins testified that he
21 is unaware of any other project to occur in the service area that would use the volume of water used in
22 the Pinnacle Peak Project or that would require a large amount of hydrant water. (Tr. at 22-23, 46.)

23
24 ²⁰ The Happy Valley Road Project, undertaken by the City of Peoria, is extending Happy Valley Road in segments to
25 connect 67th Avenue and Lake Pleasant Parkway, with the new segments to include three lanes in each direction plus bike
26 lanes, street lighting, landscaping, drainage, and a 16-inch waterline. (Ex. A-3 at MEC-R2.) Phase I of the Happy Valley
27 Road Project, for the segment from 67th Avenue to 83rd Avenue, began on January 15, 2008, and was completed by
28 December 20, 2008. (Ex. A-3.) Sunrise provided construction water for Phase I. (*Id.*) Phase II of the project, for the
segment from 83rd Avenue to Lake Pleasant Parkway, has begun and will continue into the winter of 2009. (*Id.*) The City
of Peoria is supplying all of the construction water for Phase II of the Project. (*Id.*)

²¹ Mr. Collins stated that by the end of 2008, the Pinnacle Peak Project was fully completed, the hydrant water account
with the contractor was closed, the hydrant meter had been removed, and the associated hydrant water sales had ceased.
(Ex. A-3.) Likewise, the hydrant water sales for Phase I of the Happy Valley Road Project had ceased by the end of
December 2008. (*Id.*)

1 Mr. Collins also testified that Sunrise has a restricted service area that is pretty well developed around
 2 it, surrounded by the City of Peoria and by the service areas of two other private water companies,
 3 with only a few small undeveloped spaces remaining. (See Tr. at 47-48.) Sunrise would actually like
 4 to normalize to approximately 1 million gallons per year, based on the current level of hydrant water
 5 sales, but is instead sticking with its normalization proposal. (Tr. at 104.)

6 54. Sunrise reported the following hydrant water sales for calendar years 2003 through
 7 2008:²²

Year	Total Sales (Gallons)	Project Sales (Gallons)	"Base" Sales (Gallons)
2003	1,074,700		1,074,700
2004	3,640,100		3,640,100
2005	4,759,010		4,759,010
2006	19,574,700		19,574,700
2007 (TY)	24,966,230	PP ²³ : 13,068,700	11,897,530
2008	29,489,400	PP: 9,273,300 HVR ²⁴ : 13,445,600	6,770,500

13 55. The average annual hydrant water sales for the five-year period from 2003 through
 14 2007 are 10,802,948 gallons. If the 13,068,700 gallons of hydrant water sales for the Pinnacle Peak
 15 Project are excluded for the TY, the average annual sales for this five-year period are 8,189,208
 16 gallons. Sunrise proposes that the adjusted average annual sales of 8,189,208 gallons be used as the
 17 TY sales figure, resulting in a reduction in metered water revenue of \$47,815 (calculated using the TY
 18 sales average of 16,777,022 gallons at \$2.85 per thousand gallons). (Ex. A-1.)

19 56. Sunrise provided the following hydrant water sales figures for the first four months of
 20 2009:

Month	Total Sales (Gallons) ²⁵	Adjusted ²⁶ Total Sales (Gallons)
January	7,300	7,300
February	11,800	11,800
March	190,400	190,400
April ²⁷	49,700	55,222
Total	259,200	264,722

25 ²² The sources for this data are Ex. A-1 at Sch. C-2 and Ex. A-3.

26 ²³ "PP" means Pinnacle Peak Project sales.

27 ²⁴ "HVR" means Happy Valley Road Project sales.

28 ²⁵ The source for this data is Ex. A-4.

²⁶ This adjustment is based on projected hydrant water sales for the remainder of April, calculated assuming the same level of sales for each day in April based on the figures for the first 27 days of the month (1,840.74 gallons per day).

²⁷ The April sales are for the period from April 1 through April 27, 2009. (Ex. A-4.)

1 Assuming that the daily sales for the last few days of April were at the same level as the average daily
2 sales for the first 27 days of the month, the total sales for the first four months of 2009 would be
3 264,722 gallons. If the sales for the remainder of 2009 were equivalent to the adjusted sales for the
4 first third of 2009, the total sales for 2009 would be only 794,166 gallons. Mr. Collins asserts that the
5 level of sales for the first four months of 2009 was very low because of the depressed level of
6 construction activity in Sunrise's service area. (Ex. A-4.) Mr. Collins projects total hydrant water
7 sales of 1 million gallons for 2009, for planning purposes, although he stated that the sales will be
8 much lower if the rate of sales for the first four months of 2009 continues through the rest of 2009.
9 (*Id.*) Mr. Collins expects hydrant water sales to be similarly depressed through 2010 and beyond.
10 (*Id.*)

11 57. Staff determined that because the Pinnacle Peak Project and Happy Valley Road
12 Project are concluded, it is appropriate to normalize TY hydrant water sales. (Ex. S-3.) Staff asserts,
13 however, that the hydrant water sales should be normalized through averaging hydrant water sales for
14 the four-year period from 2004 through 2007, which includes two years of moderate sales (2004 and
15 2005) and two years of high sales (2006 and 2007) and does not exclude any sales from the
16 calculation. (*Id.*) Staff's normalization results in a TY hydrant water sales figure of 13,234,760
17 gallons and an adjustment of \$33,435 to hydrant water sales. (*Id.*) Mr. Igwe testified that using
18 Sunrise's normalization method would result in understating TY revenues and overstating the revenue
19 requirement that would result from this proceeding, (Tr. at 150), and that Staff's normalization method
20 is more representative of the future because Sunrise's hydrant water sales have been trending upward
21 since 2003. (Tr. at 155-56.) Mr. Igwe also testified that he has no reason to disagree with Mr.
22 Collins's assertion that the hydrant sales for 2009 will be less than 1 million gallons, although it is not
23 possible to state what the future holds, (Tr. at 235-36), but that Staff can only normalize based on
24 historical records, not on forecasts or speculation about what the future holds, (Tr. at 260). Mr. Igwe
25 stated that Sunrise errs by eliminating what it deems to be an abnormal event in 2007 and then
26 normalizing based on the reduced amount of sales. (Tr. at 261.)

27 58. Staff and Sunrise agree that purchased pumping power costs must be reduced to
28 correspond to the normalized level of hydrant water sales. (Ex. A-6; Ex. S-3.) The adjustments

1 proposed by Sunrise and recommended by Staff differ because their recommended normalization
2 methods differ. Sunrise proposes an adjustment of (\$7,069) to purchased power to reflect the
3 normalized level of system demand, which it calculated by applying Sunrise's calculated power
4 pumping cost of \$0.4213 per thousand gallons to its calculated excess hydrant water sales of
5 16,777,072 gallons. (Ex. A-6.) Staff recommends an adjustment of (\$4,942), which it calculated by
6 applying Sunrise's calculated pumping power cost of \$0.4213 per thousand gallons to Staff's
7 calculated excess hydrant water sales of 11,731,470 gallons. (Ex. S-3.)

8 59. We find that neither Sunrise's normalization method nor Staff's normalization method
9 should be used. Rather, based upon the evidence of record, including the apparent current trend of
10 reduced hydrant water sales in Sunrise's service area, we believe that it is appropriate to normalize
11 Sunrise's TY hydrant water sales by averaging the hydrant water sales for the years 2003 through
12 2007 without excluding the sales from the Pinnacle Peak Project. Although we recognize that the
13 Pinnacle Peak Project was very large and somewhat unique, the occurrence the following year of the
14 Happy Valley Road Project causes us to believe that it would be a mistake to assume that another
15 large and somewhat unique project will not come along in Sunrise's service area in the future. As
16 Sunrise waited more than 25 years to file this rate case application, it is certainly possible that it may
17 wait quite a while before filing another. We want to assure that we do not underestimate hydrant
18 water sales going forward and thus unjustly enrich Sunrise at the expense of its ratepayers should
19 another large project be forthcoming. In addition, we recognize that Sunrise can file another rate case
20 application much more promptly should it determine that its revenue is inadequate due to the
21 normalized TY hydrant water sales adopted herein. Our normalization method results in an adjusted
22 hydrant water sales figure of 10,802,948 gallons, a TY hydrant water sales overage of 14,163,282
23 gallons, and an adjustment in TY hydrant water sales revenue of (\$40,365). This results in a
24 corresponding adjustment to TY purchased power expense of (\$5,967).

25 Outside Services

26 60. Sunrise asserts that it should be permitted to recover 50 percent of the cost of the
27 services provided to it by SRW Consulting ("SRW"), or \$13,500. (Ex. A-6.) Sunrise asserts that
28 SRW provides assistance with regulatory compliance by providing regulatory and legislative

1 monitoring and reporting services as well as assisting Sunrise to develop “communication strategies”
2 and manage issues encountered at State regulatory agencies, including the Commission.²⁸ (Ex. A-3.)
3 Sunrise believes that SRW’s services help Sunrise to stay abreast of new regulatory and legal
4 requirements and to maintain good relationships with regulatory agencies, which Sunrise believes
5 directly benefit its customers. (*Id.*) Sunrise further asserts that the “vast majority” of the services
6 provided by SRW to Sunrise are not lobbying, as defined in Arizona.²⁹ (*Id.*) Sunrise is willing to
7 agree to 50-percent recovery of these expenses because it states that SRW occasionally engages in
8 lobbying activities for Sunrise. (*Id.*) Mr. Collins acknowledged that Sunrise would be able to
9 continue providing service to its customers if it did not have the services of SRW. (Tr. at 27.) Mr.
10 Collins was not aware of any other comparably sized utility that retains a consulting firm. (Tr. at 46.)
11 Sunrise is a member of a water company association in Arizona. (Tr. at 49.) Mr. Jones testified that
12 based on his experience, this type of expense is difficult to recover in a rate case for small and large
13 companies. (Tr. at 107.)

14 61. Staff recommends disallowance of the entire \$27,000 in outside services expense for
15 services provided by SRW. (Ex. S-3.) Mr. Igwe testified that he contacted SRW and was informed by
16 SRW personnel that SRW is a political lobbying entity. (Tr. at 151.) Staff asserts that the services
17 provided by SRW are unnecessary for provision of water service and are not a recurring cost of
18 service. (Ex. S-3.) Staff adds that it is unaware of any other utility that retains the services of a
19 political lobbying company to monitor regulatory and legislative activities in Arizona and that if
20 Sunrise desires to retain the services of SRW, the costs should be borne by its shareholder rather than
21 its ratepayers. (*Id.*) Staff explained that it considers the services provided by SRW to be lobbying
22 services and that lobbying expense is a below-the-line item in ratemaking that is excluded from cost of
23 service and the determination of operating income, because it is considered to be incurred at the
24

25 ²⁸ Mr. Collins described the services provided by SRW as monitoring legislation, advising Sunrise of legislation that
26 may affect its operations, sending Sunrise a list of such bills and a white paper describing each, and providing a conduit to
27 set up meetings with various regulatory agencies with which Sunrise needs to meet regarding its business. (Tr. at 45.) Mr.
28 Collins stated that the assistance in developing communication strategies provided by SRW consists of advising Sunrise
who it needs to see and what it needs to present to the individual or group with which it is meeting. (Tr. at 48.)

²⁹ Mr. Collins stated that lobbying is defined in Arizona as “attempting to influence the passage or defeat of any
legislation by directly communicating with any legislator or attempting to influence a formal rule making proceeding by
directly communicating with any state officer or employee.” (Ex. A-3.)

1 discretion of management for purposes that are not directly beneficial to ratepayers. (Ex. S-2.) Staff
 2 stated that in this case, the lobbying expense relates to legislative activities that have no direct benefit
 3 to ratepayers. (*Id.*)

4 62. For the reasons asserted by Staff, we agree with Staff that Sunrise should not be
 5 allowed to recover any portion of the \$27,000 outside service expense incurred for the services of
 6 SRW during the TY. Thus, we will adopt Staff's recommendation and disallow such expense in its
 7 entirety.

8 Barn, Workshop, Storage, Field Office, and Yard Rental

9 63. Sunrise asserts that it should be allowed to recover \$12,487 in lease expense for barn,
 10 workshop, and storage facilities rental and \$25,108 in lease expense for field office and yard rental,
 11 for a total expense of \$37,595. (Ex. A-3.) Sunrise pays rent to Mr. Campbell for the use of these
 12 facilities that are located on his residential property, which is zoned agricultural. (Tr. at 28.) Mr.
 13 Collins provided the following explanation of why Sunrise leases the barn, workshop, storage, field
 14 office, and yard facilities from Mr. Campbell:

15 The supplies, material, tools, and equipment stored at these locations include brass
 16 fittings and copper tubing, hand tools and power equipment and other miscellaneous
 17 water facilities piping and fittings. These types of items are highly susceptible to theft
 18 and vandalism. The location has a single source of ingress and egress and is a fenced
 19 and occupied, large acreage, ranch-style residential property. These features provide
 20 excellent security and protect the items from theft and damage. In addition, Sunrise
 21 records are stored in secure containers on the property. The workshop in the barn is
 22 used by field crews to make repairs and to perform other equipment functions, and the
 23 field office is used for field crew meetings and staging.

24 ...

25 [T]he workshop is used by our field personnel on a regular basis and contained water
 26 company materials and parts at the time of Staff's visit. Small parts and tools are
 27 stored within the workshop to work on such items as fittings on hydrant meters,
 28 chlorine pumps and motors, small booster pumps and motors, and other water
 distribution and pumping equipment. Additionally, Sunrise personnel perform minor
 maintenance on the vehicles at the workshop/barn location, such as oil changes and
 washing the vehicles.³⁰

Mr. Collins testified that the agricultural zoning allows for such uses of the property and that the uses
 are also grandfathered in. (Tr. at 28-29.) Mr. Collins explained that the storage facilities are needed
 to protect the brass and copper, because both are very subject to theft, and to keep materials that have

³⁰ (Ex. A-3 at 13.)

1 rubber gaskets in an environmentally controlled building. (Tr. at 68.) Mr. Jones further testified that
2 certain company employees park their vehicles overnight at Mr. Campbell's property rather than
3 taking the vehicles home. (Tr. at 134.) Mr. Collins acknowledged that the storage and workshop
4 facilities are also used by West End and are available to Mr. Campbell for other uses, but asserted that
5 the costs attributed to Sunrise represent the value of Sunrise's use of the shared facilities. (Ex. A-4.)

6 64. There is not a lease agreement regarding the rented facilities. (Tr. at 43, 257.) The
7 rental amount apparently was determined by taking the value determined for the facilities in the last
8 rate case and making an annual adjustment to that based on annual inflation. (See Tr. at 43-44, 104.)
9 Mr. Jones testified that he believes the lease expenses for the facilities are reasonable because of the
10 location and characteristics of Sunrise's service area, which makes it difficult for Sunrise to have other
11 options for vehicle and equipment storage, and that the use of the facilities has benefited Sunrise. (Tr.
12 at 104-05.) Mr. Jones acknowledged, however, that he has not independently conducted a market
13 analysis and that there is the potential for self-dealing and for rental rates that are not based on arm's
14 length negotiations when the sole shareholder for a monopoly utility provider is leasing facilities to
15 the utility provider. (Tr. at 105-06.) Mr. Jones testified that he is not sure what the Commission could
16 do, beyond relying on the testimony in the case, to determine whether the lease expenses being passed
17 on to Sunrise's customers represent a reasonable market value rate. (*Id.*)

18 65. Staff recommends disallowance of the entire \$37,595 for the barn, workshop, storage,
19 field office, and yard rental. (Ex. S-3.) Staff inspected the facilities and determined that they are not
20 necessary for provision of service and that the costs attributed to them are excessive. (Tr. at 151.) Mr.
21 Igwe testified that the storage facility is old, the barn is old, and both are being used for both utility
22 and non-utility operations. (Tr. at 158.) Staff also expressed concern related to the creation of the
23 rental arrangements, as they were approved by Sunrise's board, which is chaired by Mr. Campbell,
24 and "there are so many conflicts, kind of affiliated non-arm's length transactions related to the
25 facilities." (Tr. at 159.) Staff observed during its field inspection that the barn houses what appears to
26 be a domestic workshop, (Ex. S-2), equipped with a vice, a tool box, and other supplies, (Ex. S-3).
27 Staff found no evidence that the barn was being used by Sunrise as a workshop or is necessary for the
28 provision of service and also found that it contained a significant number of personal household items

1 that are not required for utility service. (Ex. S-2.) Staff asserts that the \$12,487 annual rental cost for
 2 the barn, workshop, and storage space far exceeds the market rate, as the facilities are aged and lack
 3 the necessary amenities to attract such a market rate, and that the \$25,108 rental expense for the lease
 4 of a field office and yard at Mr. Campbell's residential property should be denied because Staff found
 5 no evidence supporting Sunrise's claim that these facilities are needed to provide service,³¹ and the
 6 rental expense far exceeds the market rate for these facilities. (Ex. S-2.) Staff did not, however,
 7 provide a market rate for facilities such as those being used by Sunrise.

8 66. Staff stated that the operations supervisor's office at Sunrise's rented corporate office
 9 location³² could be used for planning and meeting with field personnel and that there is ample secured
 10 space at the property on which Well # 7 is located ("Wellsite #7") to store the pipes and related
 11 materials currently found at the yard. (*Id.*) Staff's position is that the facilities are not necessary for
 12 the provision of service because Sunrise has facilities currently included in rate base that Sunrise can
 13 use for storage of some of the materials now on Mr. Campbell's property, (Tr. at 236-37), and Sunrise
 14 can use its rented space at Arrowhead Mini Storage to store all of its historical records,³³ (Tr. at 151).
 15 In addition, because Staff observed boxes labeled for West End and JDR, as well as unmarked boxes,
 16 during its field inspection at Mr. Campbell's residential property, Staff concluded that the storage
 17 facilities there are being used for non-utility purposes. (*See* Ex. S-3.)

18
 19 ³¹ Mr. Igwe stated that the workshop that he inspected "looks like something that is used for domestic use" and "doesn't
 20 appear to be used for professional service" and that he observed a commingling of personal property and utility equipment
 21 when he inspected the workshop, observing maybe one coil of copper. (Tr. at 242.) Mr. Igwe further testified that during
 22 his inspection he did not find any pumps, pipes, or materials with gaskets stored in the barn, finding instead that the pipes
 23 were stored outside of the building, in the open. (Tr. at 243-44.) Mr. Igwe also stated that he does not believe that field
 24 vehicles are parked overnight at Mr. Campbell's property, as the fleet engineers have those vehicles "24/7." (Tr. at 242-
 25 43.) Mr. Igwe observed that Mr. Campbell's property is surrounded by a barbed wire fence. (Tr. at 244.) Mr. Igwe
 26 testified that the pipes currently stored outside of the barn could be stored at Wellsite #7 and that the items of equipment
 27 and approximately 15 boxes of Sunrise historical records currently stored in the barn's storage facility, which is an "old ice
 28 storage unit," could be transferred to the Arrowhead Mini Storage facility. (Tr. at 245-46.)

³² Sunrise pays \$19,251 per year to lease corporate offices, a cost that Staff recommends be allowed as a rent expense (it
 was classified by Sunrise as a miscellaneous expense). (Ex. S-2.)

³³ Staff asserts that the rented space at Arrowhead Mini Storage is large enough to house all of Sunrise's historical
 records and recommends that Sunrise transfer all of its records there so that ratepayers are not assessed duplicative and
 unnecessary costs. (Tr. at 151; Ex. S-3.) Mr. Collins testified that Sunrise rents space at Arrowhead Mini Storage for
 storage of material used in billing that needs to be protected from the environment, including items such as envelopes and
 blank bill forms and that the space is approximately the size of a single-car garage. (Tr. at 34.) Mr. Collins testified that
 he believes a larger storage facility would be needed if Sunrise were to store its permanent historic records there rather
 than at Mr. Campbell's residence, because the historic records would be for both Sunrise and West End and date back to
 the 1980s. (Tr. at 58-59.)

1 67. Wellsite #7 is 1.83 acres in size, is surrounded by a block wall approximately 5 to 6
2 feet high, is gated, is improved with a small³⁴ building that houses a chlorination unit and some other
3 water treatment equipment, and has a 500,000-gallon water tank located toward the back of the
4 property. (Tr. at 238-40.) It is located approximately one mile from Sunrise's corporate offices. (Ex.
5 S-2.) The neighborhood in which Wellsite #7 is located is residential and primarily includes high-end
6 larger homes. (Tr. at 237-38.) Mr. Collins testified that because Wellsite #7 is zoned R-43, Sunrise
7 cannot build on a portion of the parcel smaller than one acre, and thus the portion of the parcel that is
8 smaller than one acre has no value. (Tr. at 50-52.) Mr. Collins believes the cost of the property for
9 Wellsite #7 was \$500,000³⁵ and that it was purchased because there are limited areas in the service
10 area where one could drill to get water, due to both hydrology and the limited availability of property
11 in the service area. (Tr. at 54.) Mr. Collins also testified that it would cost more than \$150,000 for
12 Sunrise to use Wellsite #7 for a workshop, field office, and storage because Sunrise would need to
13 construct a building on Wellsite #7; to obtain a Special Use Permit or rezoning of the property,³⁶
14 which would be a lengthy process and would necessitate the hiring of consultants and engineers; and
15 to obtain utility service for the property. (Tr. at 31-32.) Mr. Collins added that there would also be
16 ongoing operations and maintenance costs as a result of constructing and using a shed or storage
17 facility at Wellsite #7, including costs for electric, sewer, garbage, telephone, depreciation, and taxes.
18 (Tr. at 64.) Currently those operations and maintenance costs are not passed through to Sunrise under
19 the lease arrangement with Mr. Campbell. (Tr. at 64-65.)

20 68. Sunrise also asserts that the office Staff believes could be used by field personnel is
21 Sunrise's customer service office, which is used by its customer service representative on a full-time
22 basis for billing activities, answering customer calls, meeting with customers, and performing
23 accounts payable functions. (Ex. A-3.) Sunrise's operations supervisor also has a desk in the office
24 for his personal use when he visits the office to coordinate on customer service matters such as

25 _____
26 ³⁴ Mr. Igwe estimated that the building is approximately 800 square feet in size. (Tr. at 240.)

27 ³⁵ According to Mr. Collins, only the portion of the property used for Well #7 was included in rate base. (Tr. at 31.)

28 ³⁶ Sunrise asserts that the County is unlikely to grant a Special Use Permit to build a storage facility and that rezoning would be even more problematic, as rezoning requests for residential lots in Sunrise's service area are routinely challenged (Ex. A-3.) Mr. Collins asserted that Mr. Harry Stelling in the Maricopa County Planning and Development Department verified that any enclosed or outdoor storage at Wellsite #7 would require a Special Use Permit or rezoning. (Ex. A-4.)

1 receiving and closing customer-generated service orders and delivering meter readings. (*Id.*) Sunrise
2 asserts that the office is neither big enough nor available to stage field crews or accommodate other
3 field crew needs. (*Id.*) Sunrise also points out that the Commission allowed recovery of \$12,286 for
4 barn, workshop, storage, field office, and yard rental expense in West End's rate case, in Decision No.
5 68925 (August 29, 2006). (*Id.*) Sunrise asserts that if its standard 80/20 split of costs between Sunrise
6 and West End is used, it would result in a cost of \$49,144 for Sunrise, more than is being requested.
7 (*Id.*) Sunrise believes that the facilities are used and useful to Sunrise and that Staff's
8 recommendation to disallow these expenses should be rejected, as should Staff's recommendation that
9 Wellsite #7 be used for storage. (*Id.*) Mr. Collins testified that Sunrise needs the current facilities to
10 provide service and confirmed that Sunrise intends to use the rented facilities indefinitely. (Tr. at 32-
11 33.)

12 69. Mr. Igwe testified that he did not understand why a Special Use Permit would be
13 needed to use Wellsite #7 to store the same items that can be stored at Mr. Campbell's residential
14 property without such a Special Use Permit. (Tr. at 247-48.) Mr. Igwe acknowledged that he is not
15 familiar with R-43 zoning and whether it would allow storage of pipe at Wellsite #7 and further
16 acknowledged that addition of a shed or storage building could result in ongoing operating and
17 maintenance expenses and possibly depreciation expenses. (Tr. at 247-49.) Mr. Igwe also testified
18 that he does not know why it would cost \$150,000 to construct a facility to replace the facilities being
19 used at Mr. Campbell's residential property, as the facilities being used at Mr. Campbell's residential
20 property are not worth \$150,000. (Tr. at 240.) Mr. Igwe further testified that if Staff had not
21 recommended moving the pipes and equipment to Wellsite #7, Staff might have recommended that a
22 portion of Wellsite #7 be disallowed in rate base because a significant portion of Wellsite #7 is just
23 open space.³⁷ (Tr. at 252.)

24 70. We take official notice that Maricopa County Zoning Ordinance Article 503.2 provides
25 that R-43 zoning districts ("Rural Zoning District – One Acre Per Dwelling Unit") are permitted to
26 have the same uses as R-190 zoning districts, the ordinance for which provides, in pertinent part:

27 ³⁷ Mr. Igwe testified that Staff did not recommend disallowance of any portion of Wellsite #7 as not used and useful
28 because Staff had recommended that the pipes and other equipment stored in Mr. Campbell's yard be moved to Wellsite #7
so that the excess space would be used. (Tr. at 252.)

1 2006) and believe that it is appropriate to allow Sunrise to recover the same amount in its rental
2 expense for its use of the same facilities. While we are aware that Sunrise asserts that it uses the
3 facilities to a greater degree than does West End, we do not find that we have sufficient evidence of a
4 greater degree of usage or a greater value of these facilities to Sunrise to warrant greater recovery. We
5 caution Sunrise that we expect to see both a lease agreement and a fair market value analysis for these
6 facilities if Sunrise intends to request recovery of rental expenses for these facilities in its next rate
7 case. In addition, we believe that Sunrise should engage in due diligence to determine whether it
8 would be more economical to obtain the Special Use Permit or rezoning of Wellsite #7 so that it can
9 fully use that property for its utility operations and cease to use the facilities on Mr. Campbell's
10 residential property.

11 Rate Case Expense

12 72. In its application, Sunrise proposed to collect \$75,000 in rate case expense over a three-
13 year period. (Ex. A-5.) In its rejoinder testimony, Sunrise revised its position to request total rate case
14 expense of \$90,000, stating that it had expended approximately \$64,500 in rate case expenses through
15 March 31, 2009, and estimated that it would need to expend an additional \$25,500 to finish the case,
16 which included preparing and filing rejoinder testimony, preparing for hearing, participating in
17 hearing, preparing closing briefs, and attending Open Meeting. (Ex. A-7.) Sunrise provided a
18 document breaking down the rate case expenses as of April 30, 2009, which totaled \$64,627.31, and
19 projecting an additional cost of \$25,360 to finish the rate case, for a grant total of \$89,987.31 in rate
20 case expense. (Ex. A-8.) The additional estimated expenses to finish the case include estimated
21 payments of \$10,360 to Mr. Jones and \$15,000 in legal fees. While the estimated expenses for Mr.
22 Jones's services are broken down into specific tasks, the legal fees are provided in a lump sum with no
23 breakdown of any kind.

24 73. Mr. Jones acknowledged that Staff and Sunrise had agreed on the \$75,000 rate case
25 expense and that Sunrise did not raise the issue of increasing its rate case expense until its rejoinder
26 testimony. (Tr. at 91.) Mr. Jones explained that Sunrise had not anticipated the level of disagreement
27 regarding the hydrant water sales issue and the income tax expense issue when it created its budget of
28 \$75,000 in rate case expense. (Tr. at 91-92.) Mr. Jones also acknowledged that although Sunrise

1 knew those were issues in the case as of Staff's direct testimony, Sunrise did not update its rate case
2 expense estimate with Staff at that time. (Tr. at 92.)

3 74. When asked if it would be appropriate to amortize the rate case expense over a period
4 longer than three years, due to the more than 25 years since Sunrise last filed a rate case, Mr. Jones
5 testified that he expects Sunrise to come back to the Commission for another rate case as soon as it
6 can assemble a test year.⁴¹ (Tr. at 95-96.) Mr. Jones testified that he believes the Commission
7 generally amortizes these sorts of costs over the period of time expected to pass before another rate
8 case is filed. (Tr. at 96.) Mr. Jones testified that because the costs are incurred during an abbreviated
9 period and are not part of rate base, it is appropriate to recover them over a shorter period of time,
10 commensurate with the time between expected rate cases. (*Id.*) Mr. Jones acknowledged, however,
11 that, absent a Commission directive, it is entirely up to Sunrise when it will come in for its next rate
12 case. (Tr. at 95, 97.) Mr. Jones believes that the \$90,000 level of rate case expense is consistent with
13 the levels requested by some other companies with similar revenue. (Tr. at 99.)

14 75. Mr. Igwe testified that Sunrise's original \$75,000 rate case expense estimate was
15 understood to be all inclusive, that nothing abnormal has occurred in this proceeding to warrant
16 additional costs, and that the \$75,000 should be adequate to conclude the case. (Tr. at 162-64.) Mr.
17 Igwe further testified that Staff believes the three-year amortization period for rate case expense is
18 reasonable because Sunrise should come back in for a rate case in approximately that time frame. (*See*
19 Tr. at 164.)

20 76. We find that it is reasonable to allow Sunrise to recover its original rate case expense
21 estimate of \$75,000, plus 50 percent of the additional amount requested, for a total of \$82,500 in rate
22 case expense. Sunrise has failed to justify the full amount of its additional requested rate case
23 expense, particularly that portion attributed to legal fees, for which absolutely no breakdown of
24 additional costs for anticipated work has been provided. While we believe that Sunrise, as of the time
25 Staff filed its direct testimony, should have appreciated the complexity of the issues in this matter and

26

27 ⁴¹ Mr. Jones testified that this is because not all of the plant and other impacts had occurred by the end of the TY—
28 substantial plant was added in 2008, which is now generating a revenue requirement; expenses continue to rise; revenues
are substantially decreased; and revenues are expected to decrease more as a result of the proposed three-tiered commodity
rate design, which should encourage conservation. (Tr. at 130-31.)

1 the work required to address them and should have promptly reevaluated and provided new estimates
 2 for its rate case expense, we also believe that Sunrise may not have anticipated the amount of research
 3 it would complete regarding the income tax expense issue and the extent to which the issue would
 4 need to be addressed in testimony and its briefs.

5 Income Tax Expense

6 77. Sunrise is an S corporation, (Ex. S-2), which is a designation made under the Internal
 7 Revenue Code, (26 U.S.C. 26, Ch. 1, Subch. S). A corporation becomes an S corporation by meeting
 8 the definition for a small business corporation⁴² and making an election under 26 U.S.C. § 1362(a).
 9 (26 U.S.C. § 1361(a)(1).) An election to be an S corporation may be made for any taxable year, at any
 10 time during the preceding taxable year or at any time before the 15th day of the 3rd month of the
 11 taxable year. (26 U.S.C. § 1362(a)(1), (b)(1).) An election is effective for the taxable year for which
 12 it is made and for all succeeding taxable years, until the election is terminated by revocation, by the
 13 corporation's ceasing to be a small business corporation, or by passive investment income's meeting a
 14 certain level for a specified period of time. (26 U.S.C. § 1362(c), (d).) The significance of S
 15 corporation status is that, unlike a C corporation, an S corporation is not subject to corporate income
 16 taxes. (See 26 U.S.C. § 1363(a).) Instead, each shareholder for an S corporation includes the
 17 shareholder's pro rata share of the corporation's income, loss, deductions, and credits on the
 18 shareholder's income tax return. (See 26 U.S.C. § 1366(a)(1).) An S corporation is known as a "pass-
 19 thru entity" under the Internal Revenue Code, as are partnerships and those limited liability companies
 20 ("LLCs") that choose not to be taxed as corporations and that are thus treated as partnerships for tax
 21 purposes.⁴³

22 _____
 23 ⁴² "[S]mall business corporation" means a domestic corporation which is not an ineligible corporation and
 which does not—

(A) have more than 100 shareholders,

(B) have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an
 organization described in subsection (c)(6)) who is not an individual,

(C) have a nonresident alien as a shareholder, and

(D) have more than 1 class of stock.

26 26 U.S.C. § 1361(b)(1).

27 ⁴³ S corporations and partnerships are included in Internal Revenue Code definitions of "pass-thru entity." (See, e.g., 26
 U.S.C. § 1(h)(10).) An LLC is required by the Internal Revenue Service's regulations to choose between being taxed as a
 partnership or a corporation. (*Thompson v. United States*, 87 Fed. Cl. 728, 730 (2009) (citing 26 C.F.R. §§ 301.7701-2(a),
 28 -3(b)(1)(i).) Most LLCs choose partnership taxation so that they can avoid the two-tier system of corporate taxation. (*Id.*
 (citing *Gregg v. United States*, 186 F.Supp.2d 1123, 1126 (D. Or. 2000).)

1 78. Each year, for federal income tax purposes, an S corporation files a Form 1120S and
2 generates Schedule K-1s showing distribution of income to its shareholders, who include the Schedule
3 K-1s in their personal income tax calculations. (Tr. at 187-88.) Likewise, a partnership or LLC⁴⁴ files
4 a Form 1065 and generates Schedule K-1s for its members or partners to incorporate into their
5 personal income tax returns. (Tr. at 187-88.) A Schedule K-1 can show either a gain that would
6 increase taxable income or a loss that would reduce taxable income for a shareholder's, member's, or
7 partner's personal income tax return. (Tr. at 189.) Unlike the losses of an S corporation, the losses of
8 a C corporation cannot be used to offset income on a personal income tax return. (Tr. at 306.) A C
9 corporation is subject to "double taxation" in that any dividend issued by a C corporation is taxable to
10 the dividend recipient, whereas any dividend issued by an S corporation is not taxable to the recipient.
11 (Tr. at 305-06.) An LLC's income, distributed to its members, also is not subject to double taxation in
12 the manner that a C corporation's dividends are. (Tr. at 307.) If there is a parent-subsidiary
13 relationship in which both the subsidiary and parent are C corporations, dividends paid by the
14 subsidiary to the parent corporation are not taxable; only dividends paid by the parent corporation to
15 its individual shareholders are taxable. (Tr. at 312-13.)

16 79. Mr. Jones testified that there is really no fundamental difference between a C
17 corporation and an S corporation, except that the S corporation has made an election to be taxed under
18 Subchapter S of the tax regulations, the S corporation does not pay a corporate income tax, and the
19 shareholder pays the tax. (Tr. at 83-84.) Mr. Jones testified that Sunrise has been an S corporation at
20 least since its last TY ending July 31, 1982, and believes that it has always been an S corporation.
21 (*Id.*)

22 80. Sunrise requests recovery of either \$65,599 or \$55,449 in income tax expense. (Ex. A-
23 7.) The \$65,599 figure was calculated using federal and state corporate tax rates, assuming Sunrise's
24 filing a return as a stand-alone tax entity and assuming that the proposed rate increase were approved.
25 (*Id.*) The \$55,449 figure was calculated as an alternative, as if the S corporation had just one
26 shareholder (which it does), who filed a return as married filing jointly and derived all of his or her
27

28 ⁴⁴ Where an LLC is discussed herein as a pass-thru entity, the assumption has been made that the LLC chose to be taxed
as a partnership rather than a corporation.

1 income from the regulated utility. (*Id.*) Sunrise asserts that the income tax expense should be
2 recoverable, in spite of Sunrise's exemption from corporate income tax, because (1) Sunrise's net
3 income creates an income tax liability that is a direct result of providing water service; (2) the
4 Commission has included income tax expense in Sunrise's rates in past rate cases;⁴⁵ (3) the
5 Commission has allowed income tax expense for other S corporations and for C corporations and
6 LLCs that do not directly pay income tax; and (4) failure to allow income tax expense will weaken
7 Sunrise's financial condition and decrease the availability of funds for Sunrise to continue making
8 needed improvements to its system. (Ex. A-6.) Sunrise stated that denying recognition of income tax
9 expense would result in a decline in Sunrise's revenue and after-tax net income, resulting in lower
10 operating margins, lower debt coverage ratios,⁴⁶ lower retained earnings, and lower returns on equity.
11 (*Id.*) As a result, Mr. Jones asserted, Sunrise would have a diminished ability to raise additional
12 capital from its shareholder, Mr. Campbell, and a reduced ability to obtain debt financing from the
13 Water Infrastructure Finance Authority of Arizona ("WIFA") or other debt providers. (*Id.*) Sunrise
14 intends to use long-term debt in its capital structure in the future⁴⁷ and asserts that disallowing
15 recovery of income tax expense will negatively impact its ability to raise debt capital. (Ex. A-7.) Mr.
16 Jones estimated that excluding recovery of income tax expense would result in a 2.98-percent
17 reduction in the authorized return on equity. (Ex. A-6.)

18 81. Sunrise asserts that its alternative position, based upon filing a return as married filing
19 jointly, results in a conservative estimate because most, if not all, shareholders would have additional
20 income that would push the passed-through S corporation income into a higher tax bracket. (Ex. A-7.)
21 Mr. Jones testified that Mr. Campbell paid income taxes on Sunrise's TY taxable income of \$258,646
22 at a combined federal and state marginal rate of 32.5 percent and an overall effective rate of 23.0
23 percent, which results in actual taxes paid of \$84,060 using the marginal rate approach and \$59,489

24

25 ⁴⁵ Mr. Jones asserted that he had reviewed Sunrise's files for its two previous rate cases and determined that the
Commission approved rates that included recovery of income tax expense in both cases. (Ex. A-6.)

26 ⁴⁶ We note that Sunrise does not have any debt. (Ex. S-2.)

27 ⁴⁷ Sunrise is looking at three projects—a 500,000-gallon storage tank, interconnection of dead-end water lines to
improve service to its customers, and an additional well and transmission line. (Tr. at 56.) It is also considering
28 installation of solar panels. (*Id.*) Sunrise applied for a WIFA loan including American Recovery and Reinvestment Act of
2009 ("ARRA") funds, but was unsuccessful. (Tr. at 57.) It anticipates that the storage tank and waterline connections
would cost approximately \$1 million. (*Id.*)

1 using the effective rate approach, both of which are in excess of the alternative position recommended.
2 (Ex. A-15.) Sunrise did not provide any tax-return-related documentation to establish the actual
3 amount of taxes paid by Mr. Campbell or the amount of taxable income reported to Mr. Campbell as
4 shareholder by Sunrise.

5 82. Mr. Jones asserts that Sunrise should be treated like a C corporation utility subsidiary
6 of another C corporation that files consolidated tax returns and that treating it otherwise would be
7 discriminatory and unfair. (Ex. A-15.) Mr. Jones asserts that a number of C corporation utilities⁴⁸
8 operating in Arizona have been permitted to recover income tax expense although they do not file
9 stand-alone income tax returns and are instead included in a parent company's consolidated tax
10 returns. (Ex. A-6.) Mr. Jones testified that the Commission routinely calculates hypothetical income
11 taxes for such a subsidiary, as if the subsidiary filed a tax return on a stand-alone basis, and includes
12 the pro forma income tax expense in the subsidiary's rates without any consideration for the effects of
13 consolidation. (Tr. at 281.) Mr. Jones testified that the Commission has consistently allowed these
14 hypothetical income tax expenses to be passed through to customers through rates and that there is no
15 practical distinction between that scenario and Sunrise's scenario—just the technical distinction of a C
16 corporation being subject to the corporate tax structure as opposed to an LLC's members or S
17 corporation's shareholders being subject, generally, to the personal tax structure. (Tr. at 281-82.) Mr.
18 Jones acknowledged that the decision of what corporate structure Sunrise would take was within the
19 control of Mr. Campbell and that an S corporation has the opportunity each year to revoke its S
20 corporation status and become a C corporation. (See Tr. at 107-08.)

21 83. Mr. Jones pointed out that Sunrise was allowed to recover income tax expense in two
22 prior rate cases⁴⁹ and that the Commission also allowed recovery of income tax expense by Camp
23 Verde Water System, Inc. ("Camp Verde"), another S corporation, in Decision No. 60105 (March 19,
24 1997). (Ex. A-6.) Sunrise also established that the Commission allowed recovery of income tax
25 expense by Fisher's Landing Water and Sewer Works, LLC ("Fisher's Landing") in Decision No.

26 ⁴⁸ Sunrise asserts that APS, TEP, Southwest Gas, Arizona-American Water, Arizona Water, and Chaparral City Water
27 are all C corporation subsidiaries that have been afforded recovery of income tax expense although they are included in
their parents' consolidated tax returns. (Ex. A-7.)

28 ⁴⁹ Mr. Jones testified that the decisions were not entirely clear as to the theory under which the tax expenses were
allowed, other than the general theory that they were expenses prudently incurred in the operation of the utility. (Tr. at 86.)

1 64998 (June 26, 2002), by Winchester Water Company, LLC (“Winchester”) in Decision No. 65219
 2 (September 24, 2002), and by Wickenburg Ranch Water, LLC, (“Wickenburg Ranch”) in Decision
 3 No. 70741 (February 12, 2009). (See Tr. at 195-201; Ex. A-9; Ex. A-10; Ex. A-11; Ex. A-12; Ex. A-
 4 13; Ex. A-14.) In addition, Sunrise provided cases from New Mexico, Texas, Washington, Kansas,
 5 Wisconsin, Hawaii, New Jersey, and Vermont in which S corporations, LLCs, and sole proprietorships
 6 were allowed to recover income tax expenses in rate cases in spite of their status as non-taxable pass-
 7 thru entities.⁵⁰ (See Ex. A-15; Ex. A-16.) On the other hand, Sunrise also provided cases from
 8 Indiana, Illinois, New Hampshire, Pennsylvania, Florida, and Kentucky in which S corporations and
 9 LLCs were not allowed to recover income tax expenses in rate cases.⁵¹ (See Ex. A-15; Ex. A-16.)

10 84. Mr. Jones acknowledged that the Camp Verde case can fairly be characterized as an
 11 exception to the Commission’s standing policy of not allowing recovery of income tax expense for
 12 non-tax-paying entities, made because of the unique circumstances in the case.⁵² (Tr. at 89.) Mr.
 13 Jones also acknowledged that, except in the Camp Verde case, in those cases in which the
 14 Commission has allowed income tax recognition for an LLC or an S corporation, the Commission has
 15 not specifically discussed the issue and why the recovery was allowed. (Tr. at 285-86.) Mr. Jones
 16 also acknowledged that the only statement of the Commission’s policy on income tax expense
 17 recovery for S corporations is a statement in the Camp Verde case that, unless there is some unique
 18 circumstance, the Commission does not allow S corporations to recover income tax expenses because

19
 20 ⁵⁰ The cases provided are *Moyston v. New Mexico Pub. Svc. Comm’n*, 412 P.2d 840 (N.M. 1966); *Suburban Util. Corp.*
 21 *v. Public Util. Comm’n of Texas*, 652 S.W.2d 358 (Tex. 1983); *Washington Utils. & Transp. Comm’n v. Rainier View*
 22 *Water Co., Inc.*, 2002 WL 31432725 (Wash. Utils. & Transp. Comm’n 2002); *Greeley Gas Co. v. State Corp. Comm’n of*
 23 *State of Kansas*, 807 P.2d 167 (Kan. Ct. App. 1991); *Home Telephone Co., Inc.*, 2003 WL 21436831 (Kan. Corp. Comm’n
 2003); *Madison Telephone, LLC*, 2007 WL 2126360 (Kan. Corp. Comm’n 2007); *CenturyTel of Midwest-Kendall, Inc.*,
 2001 WL 1744202 (Wis. Pub. Svc. Comm’n 2001); *CenturyTel of Cent. Wis., LLC*, 2002 WL 31970289 (Wis. Pub. Svc.
 23 Comm’n 2002); *Kukio Util. Co., LLC*, 2008 WL 435059 (Haw. Pub. Utils. Comm’n 2008); *Maxim Sewerage Corp.*, 1998
 WL 223177 (N.J. Bd. Pub. Utils. 1998); and *Shoreham Tel. Co., Inc.*, 239 P.U.R.4th 380 (Vt. Pub. Svc. Bd. 2005).

24 ⁵¹ The cases provided are *South Haven Waterworks v. Office of Util. Consumer Counselor*, 621 N.E.2d 653 (Ind. Ct.
 App. 1993); *Monarch Gas Co. v. Illinois Commerce Comm’n*, 366 N.E.2d 945 (Ill. Ct. App. 1977); *Concord Steam Corp.*,
 25 71 N.H. P.U.C. 667 (N.H. Pub. Utils. Comm’n 1986); *Ridgelea Investments, Inc.*, 2008 WL 4696006 (Ky. Pub. Svc.
 Comm’n 2008); *Farmton Water Resources LLC*, 2004 WL 2359423 (Fla. Pub. Svc. Comm’n 2004); and *Pennsylvania*
 26 *Pub. Util. Comm’n v. Jackson Sewer Corp.*, 96 Pa. P.U.C. 322 (Pa. Pub. Util. Comm’n 2001).

27 ⁵² Mr. Jones acknowledged that Camp Verde had not requested recovery of income tax expense, that the Decision stated
 28 that the Commission had adopted a policy of not allowing recovery of income taxes for entities that are not required to pay
 income taxes, that a lender had refused to loan Camp Verde money unless the Commission allowed recovery of income tax
 expense, and that Camp Verde actually requested an upward adjustment to its rate of return as a proxy for income tax
 expense. (Tr. at 87-88.)

1 the S corporation itself does not have tax liability. (Tr. at 286.) Mr. Jones testified that he was only
2 able to find the five cited cases in which the Commission allowed an LLC or S corporation to recover
3 income tax expense, (Tr. at 287-88), and that he had found one Arizona court case, involving
4 Consolidated Water Utilities (“Consolidated”),⁵³ in which the court held that the Commission has the
5 authority to deny recovery of income tax expense based on classification, if the Commission chooses
6 to do so. (Tr. at 293-94.) Mr. Jones also confirmed that West End did not seek to recover income tax
7 expense in its last rate case.⁵⁴ (Tr. at 291.)

8 85. Staff recommends disallowance of income tax expense for Sunrise because Sunrise is
9 not a taxable entity. (Ex. S-3.) Mr. Igwe testified that the difference between allowing income tax
10 expense recovery for a utility that is a C corporation included in its parent corporation’s consolidated
11 tax return and allowing income tax expense recovery for Sunrise, an S corporation, is that the C
12 corporation utility actually is subject to the corporate income tax, whereas Sunrise, as an S
13 corporation, is not. (Tr. at 171.) Even though the subsidiary C corporation does not file its own
14 individual income tax return, its income is subject to the corporate income tax.⁵⁵ (*See id.*) Mr. Igwe
15 opined that the underlying reason for choosing to be an S corporation is generally to avoid double
16 taxation—taxation both at the corporate level and at the shareholder dividend level. (Tr. at 190.) Mr.
17 Igwe disagreed with Sunrise’s assertion that disallowance of income tax expense recovery would
18 impair Sunrise’s ability to make needed capital improvements and would weaken its financial
19 condition, pointing out that the 10-percent rate of return should be an incentive for others to invest in
20 Sunrise. (Tr. at 161-62.) Mr. Igwe also pointed out that Sunrise can elect to be treated as a C
21 corporation and subject to income tax if it desires to recover income tax expense. (Tr. at 160.)

22 86. Staff characterizes the allowance of income tax expense recovery by Sunrise in prior
23 rate cases as inadvertent and states that the error should not be perpetuated in this case. (Ex. S-3.)
24

25 ⁵³ Mr. Jones originally testified that Consolidated is an S corporation, but later corrected his testimony to indicate that
26 Consolidated is a partnership, although he said that the tax treatment is the same. (Tr. at 313.) Mr. Jones believes that the
27 Consolidated case is the only Arizona court case addressing the issue. (Tr. at 294.)

28 ⁵⁴ Mr. Jones sought to distinguish West End by stating that it applied to have its rates set on the basis of an operating
margin because it has no rate base and thus had no rate of return issues. (Tr. at 302.)

⁵⁵ Mr. Igwe testified that the Commission would determine the income tax expense by looking at the revenues generated
by the subsidiary utility and then applying the appropriate corporate tax rate to determine the subsidiary utility’s tax
liability, without reviewing the parent holding company’s tax return. (Tr. at 178.)

1 Staff also asserts that Staff erred in recommending recovery of income tax expense for Wickenburg
 2 Ranch and intends to rectify the situation in the future;⁵⁶ that the same type of error has already been
 3 rectified for Winchester and Fisher's Landing in cases subsequent to those cited by Sunrise; and that
 4 the decision to allow Camp Verde recovery of income tax expense in Decision No. 60105 was based
 5 on a bank's refusal to provide Camp Verde a loan unless Camp Verde received rates that included
 6 recovery of income taxes, which was a unique circumstance. (Ex. S-4.) Staff provided the following
 7 excerpt from Decision No. 60105 as support for its position that the Commission has established a
 8 policy of not allowing income tax expense recovery for entities that are exempt from income taxes and
 9 its assertion that allowing Camp Verde recovery of income tax expenses was an exception granted in
 10 the Commission's discretion solely because of an extraordinary circumstance surrounding the peculiar
 11 debt covenant imposed by CoBank as a prerequisite for Camp Verde's obtaining financing:

12 The Company did not request any income taxes since it is a Subchapter S corporation
 13 and the Commission has adopted a policy of not allowing income taxes for entities
 14 which are not required to pay income taxes. Similarly, Staff did not recommend any
 15 income taxes. At the hearing, the Company indicated that CoBank would not loan the
 16 Company money unless the rates approved herein would provide for income taxes that
 17 would be paid by the individual shareholders.

18 Under the circumstances presented herein, we are not going to adjust the rate of return
 19 for income taxes as requested by the Company. We are going to allow income taxes in
 20 this case at the lowest individual/corporate income tax rates of 23.36 percent for
 21 combined Federal and State income taxes.⁵⁷

22 87. Staff also provided a table listing eight LLCs with recent rate filings, none of which
 23 sought recovery of income taxes in rates, and for each of which Staff did not recommend allowing
 24 recovery of income tax expenses.⁵⁸ (Ex. S-4.) Mr. Igwe believes that an LLC and an S corporation
 25 should be treated identically in terms of income tax expense recovery. (Tr. at 193.) Mr. Igwe testified

26 ⁵⁶ Staff also asserted that the Wickenburg Ranch case involved a new Certificate of Convenience and Necessity (CC&N)
 27 and thus that its projected costs were not subjected to the same level of scrutiny as they would be in a rate case. (Ex. S-4.)
 28 Staff is correct that the figures used in that case were projections, but is incorrect about the nature of the case, as the case
 was actually a rate case—a very unusual rate case for a company that had never had any customers although it had held its
 CC&N for more than 30 years. (Decision No. 70741 (February 12, 2009).) Because no historical TY data was available,
 Staff and Wickenburg Ranch agreed that its rate application would be treated like a new CC&N application. (*Id.*) The
 issue of whether it is appropriate for an LLC to recover income tax expense was not discussed during the Wickenburg
 Ranch hearing. (*See* W-03994A-07-0657, Tr. of Hearing of Oct. 8, 2008.)

⁵⁷ Decision No. 60105 at 9.

⁵⁸ These companies are Empirita Water Company, LLC; Christopher Creek Haven Water; Utility System, LLC dba
 Gardner Water Co.; Montezuma Rimrock Water Co., LLC; Utility System, LLC – Water Division; JNJ Enterprises, LLC,
 Christopher Creek Haven Division; Eagletail Water Company, LLC; and Naco Water Company, LLC. (Ex. S-4, Table A.)

1 that Staff has recommended no income tax recovery in the pending rate case for Johnson Utilities
 2 LLC, a Class A utility,⁵⁹ (Tr. at 232-33), and that a review of pending and recent rate case dockets
 3 involving LLCs revealed that Staff consistently is not recommending recovery of income tax expense
 4 for LLCs. (Tr. at 317-18.) The crux of Staff's position is that there is a distinction between a C
 5 corporation as a taxable entity and an S corporation or LLC as a non-taxable entity, in that the C
 6 corporation has tax liability as a cost of providing service, whereas an S corporation or LLC does not.
 7 (See Tr. at 321-22.) Staff believes that the distinction makes it appropriate to allow recovery of tax
 8 expenses for a taxable entity and not for a non-taxable entity. (*See id.*)

9 88. Although we are interested by the apparent split of opinion among the public utility
 10 commissions in various states in terms of the appropriateness of recognizing income tax recovery for
 11 pass-thru entities and may like to explore this further in a different docket when time and resources
 12 allow, we believe that at this time it is appropriate to rely upon the bulk of our own prior cases
 13 involving pass-thru entities in determining the appropriate treatment of Sunrise's request to recover
 14 pro forma income tax expenses in this case. The Commission has established a long-standing policy
 15 of denying recovery of income tax expenses for pass-thru entities and apparently has varied from it, at
 16 least in recent years, only as an exception made under unique circumstances or as an inadvertent error.
 17 The Commission's policy is apparent in the Consolidated case;⁶⁰ was expressly stated in the Camp
 18 Verde case; is strongly suggested and supported by S corporations' and LLCs' currently almost
 19 unanimously not requesting recovery of income tax expenses in their rate applications; is apparent in
 20 the almost complete lack of discussion regarding the issue in recent Commission decisions; and is
 21 apparent from Staff's testimony in this case. We have inadvertently allowed recovery of income tax

22 _____
 23 ⁵⁹ Docket No. WS-02987A-08-0180.

24 ⁶⁰ *Consolidated Water Utils., Ltd. v. Arizona Corp. Comm'n*, 178 Ariz. 478 (1993). In the Consolidated case, the Court
 25 of Appeals found that the Commission constitutionally has very broad power to prescribe classifications and establish
 26 categories to consider in establishing rates and to treat entities accordingly. (See 178 Ariz. at 483-84.) The Court stated:
 27 "Recognizing that two of the other forty-nine states have allowed income tax expenses incurred by utility companies
 28 operating as Subchapter S corporations or sole proprietorships, we also recognize that, in Arizona, the decision to allow or
 disallow that tax expense is to be made by the Commission, not the courts." (178 Ariz. at 484.) We also note that the New
 Mexico case cited by Consolidated in its case, and cited by Sunrise in this case, apparently required recovery of income tax
 expenses based on a finding that the New Mexico Commission lacks the authority to make distinctions based on
 classifications in establishing rates. (See *Moyston v. New Mexico Pub. Serv. Comm'n*, 412 P.2d 840, 847-48 (1966).) The
 Texas case cited in the Consolidated case cited the Moyston case as "the only determination by a court of last resort on this
 question" and appears to have relied upon it at least to some degree. (See *Suburban Util. Corp. v. Public Util. Comm'n of
 Texas*, 652 S.W.2d 358, 363 (Tex. 1983)).

1 expenses in several isolated incidents involving pass-thru entities, most recently for Wickenburg
 2 Ranch. This was done in error, not as an indication of a change in the Commission's policy. We are
 3 confident that the errors will not be repeated in the near future and that the Wickenburg Ranch
 4 anomaly, which is the only un-remedied anomaly of which we are aware at this time, will be remedied
 5 in its next rate case. Because it has long been our policy not to allow recovery of these hypothetical
 6 income tax expenses for non-taxable pass-thru entities, because we recognize that C corporation
 7 subsidiaries included in a parent corporation's consolidated income tax return are different than an S
 8 corporation because they are actually taxable entities,⁶¹ because we have no documentary evidence
 9 before us of Sunrise's income passed through to Mr. Campbell or that Mr. Campbell has actually paid
 10 any income taxes on that income,⁶² and because Sunrise can easily become a C corporation if it
 11 chooses to do so in order to obtain recovery of income tax expenses in future rate cases, we will not
 12 allow Sunrise to recover any income tax expenses in this matter.⁶³ In addition, because allowing
 13 recovery of accumulated deferred income tax ("ADIT") as an addition to rate base, as proposed by
 14 Sunrise and recommended by Staff, would be inconsistent with the disallowance of recovery of
 15 income tax expense, we also will not allow the proposed addition of \$143,202 in ADIT to Sunrise's
 16 rate base.

17 Break-over Point to Third-Tier for ¾" Meter

18 89. The parties agree on monthly minimum charges, on a three-tiered commodity rate
 19 design for the ¾" meter size, and on a two-tiered commodity rate design for larger meter sizes, but
 20 disagree on the break-over point to the third tier for the ¾" meter size. Sunrise believes that the break-
 21 over point should be set at 18,000 gallons, roughly equivalent to average usage for a residential
 22 customer with a ¾" meter on its system, and that this will send proper conservation price signals to its
 23

24 ⁶¹ We also note that the rate cases for these C corporation subsidiaries frequently involve settlement agreements, which
 result in numerous issues, such as income tax expense recovery, not being fully litigated.

25 ⁶² We note that it should have been very easy for Sunrise to provide a Schedule K-1 and a Form 1120S to establish the
 actual taxable income for the TY that was passed through to Mr. Campbell and that Sunrise did not choose to do so.
 26 Rather, we have the bare assertions of Mr. Jones as to the taxable income, along with two different hypothetical tax
 expense figures. (See Ex. A-15.)

27 ⁶³ We are cognizant that although we are disallowing, with Sunrise's acquiescence, 50 percent of Mr. Campbell's salary
 for the TY, a downward adjustment of \$68,000, Mr. Campbell actually received that amount in salary in the TY and almost
 28 certainly continues to receive that amount, or more, which should assist him in affording to pay the personal income taxes
 that accrue to him as a result of Sunrise's income.

1 customers without placing an undue burden on below-average usage. (Ex. A-6.) Mr. Jones testified
2 that establishing the break-over point at approximately average usage for the 3/4" meter was intended to
3 make the adjustment more gradual, as Sunrise is going from a non-conservation-oriented single-tiered
4 commodity rate to a conservation-oriented three-tiered commodity rate design. (Tr. at 123.) Mr.
5 Jones testified that it may be appropriate to lower those break-over points as time goes by. (See Tr. at
6 123-24.) Mr. Jones agrees that a lower break-over point is more likely, all things being equal, to
7 promote efficient use of water than is a higher break-over point. (Tr. at 93.)

8 90. Staff asserts that the break-over point should be set at 13,000 gallons, roughly
9 equivalent to median usage for a residential customer with a 3/4" meter on Sunrise's system. (Ex. S-2.)
10 Mr. Igwe testified that Staff considered several factors in determining that the third-tier break-over
11 point for the 3/4" meter should be set at 13,000 gallons, including the need to conserve water in
12 Arizona; the high usage patterns in Sunrise's service area; and the third-tier break-over points
13 established for water utilities of a similar size, which would generally be approximately 9,000 or
14 10,000 gallons. (Tr. at 165.)

15 91. We find that it is appropriate to set the third-tier break-over point for a 3/4" meter at
16 13,000 gallons, as recommended by Staff, because doing so should encourage conservation of water
17 more effectively than would a higher break-over point. The lower break-over point should cause more
18 of Sunrise's customers to rethink their consumption patterns and is more in keeping with the third-tier
19 break-over points established for other water utilities of similar size. We do not desire for Sunrise to
20 provide its customers the message that they should not be required to pay more for high water
21 consumption. We also find that it is appropriate to adopt Staff's recommended rate design.

22 5/8" x 3/4" Meter Size Service Line and Meter Installation Charges

23 92. The parties agree on service line and meter installation charges, except as to the
24 inclusion of a service line and meter installation charge for the 5/8" x 3/4" meter size. Sunrise states
25 that it does not offer that meter size as a service option due to the large lot sizes throughout its service
26 area and requests that no service line and meter installation charge be included for that meter size.
27 (Ex. A-6.) Sunrise does not believe that there is any possibility of smaller lot sizes arising in the
28 service area and is concerned that customers may, in an attempt to save money, contact Sunrise and

1 express a desire to have their meter size changed to the 5/8" x 3/4" meter size, which Mr. Jones testified
2 would not comply with the plumbing code for the service area. (Tr. at 114.) Sunrise would like to be
3 able to avoid those discussions with customers by not having the 5/8" x 3/4" meter size included in its
4 tariff. (*Id.*)

5 93. Staff has included service line and meter installation charges for the 5/8" x 3/4" meter
6 size, apparently just in case that meter size should be made available in the future. (Ex. S-2.) Staff
7 has not, however, included a monthly minimum charge or commodity rates for the 5/8" x 3/4" meter
8 size, which suggests that Staff does not expect that meter size to be in use any time soon. (*See id.*)

9 94. We find that it is unnecessary to include service line and meter installation charges for
10 the 5/8" x 3/4" meter size. Sunrise currently does not serve any meters of this size and has indicated
11 that use of this smaller meter size for a residence of the size predominating in its service area would be
12 a violation of local building codes. In addition, Sunrise has voiced a concern that customers desiring
13 to lower their water costs may seek to change their meters to the smaller meter size even though doing
14 so would be in violation of local building codes. Although we believe that this is unlikely, it is
15 unnecessary to include the smaller meter size service line and meter installation charges and create the
16 risk that Sunrise's time would be spent dealing with such customer inquiries.

17 Service Charges

18 95. Sunrise requests that it be permitted to charge the same service charges as authorized
19 for West End in Decision No. 68925. (Ex. A-6.) Sunrise asserts that adopting the same service
20 charges will provide administrative convenience for the companies' shared customer service staff.
21 (*Id.*)

22 96. Mr. Igwe testified that Staff did not recommend use of the same service charges
23 because Staff has no evidence that Sunrise has the same cost profile as West End. (Tr. at 166.) In
24 addition, Mr. Igwe testified that the service charges are not that far apart. (*Id.*)

25 97. We have reviewed the service charges currently imposed by Sunrise; the service
26 charges requested by Sunrise, which are consistent with the service charges approved for West End in
27 Decision No. 68925; and the service charges recommended by Staff. We have also reviewed the other
28 rates and charges authorized for West End in Decision No. 68925. From our review, we conclude that

1 the rates and charges authorized for West End are generally higher, across the board, than are those
2 requested by Sunrise. This bolsters Staff's assertion that there is no evidence showing that Sunrise has
3 the same cost profile as West End. Because Sunrise's only argument in favor of uniformity in service
4 charges is convenience, and it is clear that Sunrise and West End are already assessing different rates
5 and charges and would largely continue to do so even if the service charges were made uniform, we
6 do not believe that it is necessary or appropriate to increase Sunrise's service charges to the extent
7 necessary to make them consistent with those of West End, and we will not do so.

8 Establishing Rate Base and Rates

9 98. We find that Sunrise's OCRB is \$1,040,202, calculated by modifying Staff's
10 recommended OCRB of \$1,183,834 to exclude \$143,202 in ADIT. As Sunrise has not requested use
11 of RCNRB to determine its FVRB, we find that Sunrise's OCRB should be treated as its FVRB.
12 Thus, we find that Sunrise's FVRB is equivalent to its OCRB of \$1,040,202.

13 99. We find that the 10-percent rate of return agreed upon by Sunrise and Staff is
14 appropriate, and we will adopt it.

15 100. Under Sunrise's current rates, the monthly bill for a customer served by a ¾" meter
16 with average consumption is \$62.68, and the monthly bill for such a customer with median usage is
17 \$50.41. (Ex. A-1.) Sunrise's proposed rates would increase the monthly bill for the ¾" meter
18 customer with average consumption to approximately \$65.31, representing an increase of \$2.63, or
19 approximately 4.2 percent. (Ex. A-6.)

20 101. Staff's recommended rates would increase the monthly bill for a customer served by a
21 ¾" meter with average consumption to \$63.90, representing an increase of \$1.22, or approximately
22 1.95 percent. (Ex. S-2.)

23 102. Based on the adjustments made herein, we find that Sunrise should be permitted to
24 recover operating income of \$104,020 and total operating expenses of \$1,295,217, for an overall
25 revenue requirement of \$1,399,237. This overall revenue requirement is just and reasonable and will
26 be adopted.

27 103. Applying the overall revenue requirement established herein and Staff's recommended
28 rate design, which is adopted herein, the monthly bill for a customer served by a ¾" meter with

1 average consumption will be increased from \$62.68 to \$63.90, representing an increase of \$1.22, or
2 approximately 1.95 percent over current rates.

3 **Commingling and Non-Arm's Length Transactions**

4 104. Staff expressed great concern about the commingling of Sunrise's operations with Mr.
5 Campbell's other business ventures, a concern that Mr. Igwe stated he had shared with Mr. Collins,
6 Ms. Howard, and Mr. Campbell. (Tr. at 252-53.) Staff found allocations of cost from Sunrise's
7 general ledger to West End and to Mr. Campbell and that the barn storage facility was used for storage
8 of records belonging to Sunrise, West End, and Mr. Campbell. (Tr. at 253.) Mr. Igwe also testified
9 that Mr. Campbell had been involved in two real estate developments in the service area. (*Id.*) Staff is
10 concerned when it observes a situation in which regulated and non-regulated entities are operating
11 under the same ownership and direction and when records are commingled and employees are shared.
12 (*See* Tr. at 257.) Staff also determined that Mr. Campbell has leased property, both real and
13 personal,⁶⁴ to Sunrise without the benefit of lease agreements and at prices that Staff believes exceed
14 fair market values. We are also cognizant that Mr. Campbell has been receiving a salary that is
15 excessive in light of the work that he apparently does for Sunrise and that Sunrise asserted that Mr.
16 Campbell works for Sunrise full time, a contention for which there is not adequate support in this
17 record.

18 105. We share Staff's concern that Sunrise is operated in a manner that makes it difficult to
19 differentiate its operations from those of West End and Mr. Campbell's other business ventures and
20 personal activities. We are putting Sunrise on notice that, in future rate cases, we expect to see
21 documentation establishing the market value of any property leased to Sunrise by Mr. Campbell or
22 another affiliate; records supporting Sunrise's use of any portion of facilities or property shared by
23 Sunrise and another affiliate or enterprise of Mr. Campbell; contemporaneous records supporting the
24 time each employee shared by Sunrise and another affiliate or enterprise of Mr. Campbell, including
25 Mr. Campbell, spent working for Sunrise; and separation of accounting records and transactions for
26 Sunrise and West End. The Commission disfavors non-arm's length transactions and has broad

27 _____
28 ⁶⁴ We refer here to the lease of the barn, workshop, storage, field office, and yard facilities and of the two trucks for which Staff determined that the lease expenses exceed fair market value.

1 authority to scrutinize such transactions and to disallow expenses related to them that are not fully
2 justified.⁶⁵

3 Off-Tariff Rates

4 106. We are concerned that Sunrise has implemented a 3" meter hydrant water monthly
5 minimum charge and a coin-operated standpipe rate without first obtaining approval from the
6 Commission. While it appears from the evidence in this matter that Sunrise has been charging its
7 approved commodity rate for the water obtained through these hydrants and standpipes, Sunrise does
8 not currently have a tariffed monthly minimum charge for a 3" hydrant meter, or any 3" meter, and
9 does not currently have a standpipe water rate, or any rate, that does not require a monthly minimum
10 charge. We are approving a 3" meter hydrant water monthly minimum charge and a coin-operated
11 standpipe commodity rate that does not require assessment of a monthly minimum charge in this
12 Decision and are not taking any adverse action against Sunrise herein as a result of its past actions in
13 this regard. But Sunrise needs to be aware that we are concerned about its commitment to following
14 the Commission's Orders and rules. Accordingly, Sunrise should be on notice that subsequent
15 violations of Commission Orders and rules may lead to further steps, which could include the filing of
16 an Order to Show Cause or other adverse actions.

17 CONCLUSIONS OF LAW

18 1. Sunrise is a public service corporation within the meaning of Article XV of the
19 Arizona Constitution and A.R.S. §§ 40-250, 40-251, and 40-367.

20 2. The Commission has jurisdiction over Sunrise and the subject matter of the
21 application.

22 3. Notice of Sunrise's application and of the hearing in this matter was provided in
23 accordance with the law.

24 4. Sunrise's FVRB is \$1,040,202.

25 5. The rates and charges established herein reflect the adjustments made based upon our
26 determinations set forth in the Findings of Fact herein.

27
28 ⁶⁵ See *U.S. West Communications, Inc. v. Arizona Corp. Comm'n*, 185 Ariz. 277, 282 (Ariz. Ct. App. 1996).

6. The rates, charges, and conditions of service established herein are just and reasonable and in the public interest.

ORDER

IT IS THEREFORE ORDERED that Sunrise Water Co. is hereby authorized and directed to file with the Commission's Docket Control, as a compliance item in this docket, on or before January 1, 2010, a revised tariff setting forth the following rates and charges:

MONTHLY USAGE CHARGE:

3/4" Meter	\$ 17.00
1" Meter	28.33
1 1/2" Meter	56.65
2" Meter	90.64
3" Hydrant Meter	181.28
Coin-operated Standpipe	N/A

COMMODITY RATES (Per 1,000 Gallons):

<u>3/4" Meter</u>	
From 1 to 4,000 Gallons	\$1.70
From 4,001 to 13,000 Gallons	2.47
Over 13,000 Gallons	3.09
<u>1" Meter</u>	
From 1 to 27,000 Gallons	\$2.47
Over 27,000 Gallons	3.09
<u>1 1/2" Meter</u>	
From 1 to 35,000 Gallons	\$2.47
Over 35,000 Gallons	3.09
<u>2" Meter</u>	
From 1 to 65,000 Gallons	\$2.47
Over 65,000 Gallons	3.09
<u>3" Hydrant Meter</u>	
All Usage	\$2.47
<u>Coin-operated Standpipe</u>	
All Usage	\$2.47

SERVICE LINE AND METER INSTALLATION CHARGES:

(Refundable pursuant to A.A.C. R14-2-405)

	<u>Service Line Charge</u>	<u>Meter Charge</u>	<u>Total Charge</u>
3/4" Meter	\$445.00	\$ 255.00	\$ 700.00
1" Meter	495.00	315.00	810.00
1-1/2" Meter	550.00	525.00	1,075.00
2" Turbine	830.00	1,045.00	1,875.00
2" Compound	830.00	1,890.00	2,720.00
3" Meter & Above	Cost	Cost	Cost

SERVICE CHARGES:

Establishment	\$25.00
Establishment (After Hours)	35.00
Reconnection (Delinquent)	15.00
Reconnection (Delinquent, After Hours)	25.00
Meter Test	25.00
Deposit Requirement:	*
Residential Customer	
Deposit Requirement:	*
Non-Residential Customer	
Deposit Interest	6.00%
Re-establish within 12 months	**
NSF Check	\$35.00
Meter Re-Read	10.00
Deferred Payment, Per Month	1.50%
Late Charge Per Month	1.50%
Moving Customer Meter	Cost

PRIVATE FIRE SERVICE:

4" Fire Line Service	\$25.00
6" Fire Line Service	35.00
8" Fire Line Service	45.00

* Per Commission Rule A.A.C. R14-2-403(B)

** Months off system x monthly minimum bill

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax, per Commission Rule A.A.C. R14-2-409(D)(5).

All items billed at cost shall include labor, materials, and parts and all applicable taxes.

IT IS FURTHER ORDERED that the rates and charges set forth above shall be effective for all services rendered by Sunrise Water Co. on and after January 1, 2010.

IT IS FURTHER ORDERED that Sunrise Water Co. shall notify its customers of the revised schedule of rates and charges authorized herein by means of an insert in its next regularly scheduled

1 billing, or by separate mailing, in a form acceptable to the Commission's Utilities Division Staff.

2 IT IS FURTHER ORDERED that Sunrise Water Co. shall ensure that it charges only those
3 rates and charges that are specifically authorized by its Commission-approved tariffs.

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

5 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.
6
7

8 CHAIRMAN _____ COMMISSIONER

9 _____
10 COMMISSIONER COMMISSIONER COMMISSIONER

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

17 _____
18 ERNEST G. JOHNSON
19 EXECUTIVE DIRECTOR

20 DISSENT _____

21 DISSENT _____
22
23
24
25
26
27
28

1 SERVICE LIST FOR: SUNRISE WATER CO.

2 DOCKET NO.: W-02069A-08-0406

3

4 Craig Marks
4 CRAIG A. MARKS, P.C.
5 10645 North Tatum Blvd., Suite 200-676
5 Phoenix, Arizona 85028
6 Attorney for Sunrise Water Co.

7 Janice Alward, Chief Counsel
7 Legal Division
8 ARIZONA CORPORATION COMMISSION
9 1200 West Washington Street
9 Phoenix, Arizona 85007

10 Steven M. Olea, Director
11 Utilities Division
12 ARIZONA CORPORATION COMMISSION
12 1200 West Washington Street
13 Phoenix, Arizona 85007

14

15

16

17

18

19

20

21

22

23

24

25

26

27

28