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BEFORE THE ARIZONA CORPORATION COMMISSION

8 IN THE MATTER OF THE
 9 APPLICATION OF BLACK MOUNTAIN
 10 SEWER CORPORATION, AN ARIZONA
 CORPORATION, FOR A
 11 DETERMINATION OF THE FAIR
 VALUE OF ITS UTILITY PLANT AND
 12 PROPERTY AND FOR INCREASES IN
 ITS RATES AND CHARGES FOR
 13 UTILITY SERVICE BASED THEREON.

DOCKET NO: SW-02361A-08-0609

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 16 **BLACK MOUNTAIN SEWER CORPORATION**
 17 **INITIAL CLOSING BRIEF**

December 14, 2009

Arizona Corporation Commission
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TABLE OF ABBREVIATIONS AND CONVENTIONS

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

BLACK MOUNTAIN SEWER CORPORATION ("BMSC") PRE-FILED TESTIMONY

8	Pre-Filed Testimony	Hearing Exhibit	Abbreviation
9	Direct Testimony of Greg Sorensen	A-1	Sorensen Dt.
10	Direct Testimony of Tom Bourassa (Rate Base)	A-4	Bourassa Dt.
11	Direct Testimony of Tom Bourassa (Cost of Capital)	A-5	Bourassa COC Dt.
12	Rebuttal Testimony of Greg Sorensen	A-2	Sorensen Rb.
13	Rebuttal Testimony of Tom Bourassa (Rate Base)	A-6	Bourassa Rb.
14	Rebuttal Testimony of Tom Bourassa (Cost of Capital)	A-7	Bourassa COC Rb.
15	Rejoinder Testimony of Greg Sorensen	A-3	Sorensen Rj.
16	Rejoinder Testimony of Tom Bourassa (Rate Base)	A-8	Bourassa Rj.
17	Rejoinder Testimony of Tom Bourassa (Cost of Capital)	A-9	Bourassa COC Rj.
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* BMSC filed its Final Schedules on December 10, 2009.

1 **RESIDENTIAL UTILITY CONSUMER OFFICE (“RUCO”)**
2 **PRE-FILED TESTIMONY**

3

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
4 Direct Testimony of Rodney Moore	R-3	Moore Dt.
5 Direct Testimony of William Rigsby	R-6	Rigsby Dt.
6 Surrebuttal Testimony of Rodney 7 Moore	R-4	Moore Sb.
8 Surrebuttal Testimony of William Rigsby	R-7	Rigsby Sb.

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11 **STAFF**
12 **PRE-FILED TESTIMONY**

13

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
14 Direct Testimony of Dorothy Hains	S-1	Hains Dt.
15 Direct Testimony of Juan Manrique	S-3	Manrique Dt.
16 Direct Testimony of Crystal Brown	S-5	Brown Dt.
17 Surrebuttal Testimony of Dorothy Hains	S-2	Hains Sb.
18 Surrebuttal Testimony of Juan 19 Manrique	S-4	Manrique Sb.
20 Surrebuttal Testimony of Crystal Brown	S-6	Brown Sb.
21 Supplemental Surrebuttal Testimony 22 of Crystal Brown	S-7	Brown Supp. Sb.

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**BOULDERS HOMEOWNERS' ASSOCIATION ("BHOA")
PRE-FILED TESTIMONY**

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Direct Testimony of Les Peterson	BHOA-4	Peterson Dt.
Surrebuttal Testimony of Les Peterson	BHOA-5	Peterson Sb.

**TOWN OF CAREFREE ("CAREFREE")
PRE-FILED TESTIMONY**

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Direct Testimony of Brian Kincaid	Carefree-1	Kincaid Dt.

**DENNIS E. DOELLE, D.D.S. ("DOELLE")
PRE-FILED TESTIMONY**

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
July 2009 Direct Testimony of Dennis Doelle	Doelle-1	Doelle Dt.
September 2009 Direct Testimony of Dennis Doelle	Doelle-2	Doelle Supp. Dt.
Surrebuttal Testimony of Dennis Doelle	Doelle-3	Doelle Sb.

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OTHER PORTIONS OF THE RECORD

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Decision No. 69164 (December 5, 2006)	BHOA-1	Decision No. 69164
Hearing Transcript November 18-25, 2009	--	Tr.

2261636.6

1 **INTRODUCTION**

2 Black Mountain Sewer Corporation's last rate case was the first for an Algonquin
3 Water-owned utility in Arizona. In that case, the "most contentious issue" involved
4 claims by customers, the Town of Carefree and the BHOA, that the Company's "system
5 emits significant odors." The next most contentious issue involved Algonquin's (now
6 Liberty Water's) shared services model. Liberty Water operates BMSC, along with
7 several other affiliated water and sewer utilities in Arizona, and in the prior test year for
8 BMSC, the costs were market based and included a profit. The Commission found the
9 "additional profit margin" on affiliated transactions to be "inherently unreasonable."

10 In this rate case, the remedies to the systemic odor problems are being added to
11 plant in service without dispute; and the Company's response to its customers and this
12 Commission's order has been described by the ratepayers as nothing short of
13 "outstanding" and "wonderful." BMSC and Liberty Water responded just as seriously to
14 the Commission's expressed concern over its shared services model. Liberty Water now
15 operates BMSC and the other utilities on an actual cost basis. All profit is eliminated,
16 direct costs are charged to each utility where possible, and shared costs are allocated
17 consistent with methodologies used by other regulated water providers. Given these
18 efforts by BMSC and Liberty Water, none of which are in dispute, it is ironic that the two
19 most contentious issues in this rate case are the resolution of another "odor problem," and
20 other issues with the Company's shared services model.

21 These are not the only issues in dispute, but they serve to illustrate the position in
22 which BMSC finds itself in this rate case. BMSC and Liberty Water have indisputably
23 taken the steps this Commission has asked of a responsive utility provider, and for a
24 pleasant change, there is compelling evidence and public comment to show their success.
25 BMSC and Liberty Water wish to continue that success and invest capital prudently for
26 the direct benefit of ratepayers. In response, RUCO opposes the request of the

1 Company's residential ratepayers for plant closure and approval of a rate recovery
2 mechanism, and recommends an 8.2 percent rate of return coupled with the same
3 hypothetical capital structure the Commission held to be "results oriented" in the last rate
4 case. Staff, among numerous adjustments to rate base and expenses, excludes nearly
5 \$200,000 of rate base, rejects 90 percent of reasonable allocated corporate administration
6 costs as part of the shared services model, and inexplicably disallows an increase in the
7 operating costs charged by Liberty Water. Is it any wonder that the undisputed evidence
8 also shows the difficulty BMSC is having in attracting capital to Arizona when its parent
9 has investment options in other states?

10 The evidence shows that BMSC must prove its capital requirements internally and
11 persuade its parent company, and in turn its unitholders, that investments in Arizona
12 utilities are prudent. BMSC's parent has consistently shown an ability and willingness to
13 provide BMSC with capital, so long as the opportunity to earn a fair return on its
14 investment is available. Respectfully, the Commission should not share in Staff and
15 RUCO's failure to recognize the value of a quality water and sewer provider with access
16 to capital for prudent investment. Numerous past and pending Commission dockets show
17 that wherever Liberty Water has gone in Arizona during the past decade, calls for action
18 by this agency have been heeded, inherited problems have been resolved, and service has
19 improved. If the Commission were to issue an order: rejecting a call for capital the
20 shareholder is willing to meet and the ratepayers are eager to pay for; or prohibiting the
21 allocation of costs that are part of a model that consistently delivers high service quality;
22 or depriving the Company of rates that ensure an adequate opportunity to earn a
23 competitive rate of return on its investments, BMSC will have more difficulty attracting
24 future capital to the benefit of ratepayers. Such findings on the issues in dispute would

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1 also do little to encourage Liberty Water to continue to maintain the highest possible level
2 of service at the lowest possible price.¹

3 **BRIEF OVERVIEW OF BMSC'S REQUEST FOR RATE RELIEF**

4 BMSC filed this case on December 19, 2008, seeking relief based on a test year
5 ending June 30, 2008. In its initial application, BMSC sought a determination of fair
6 value rate base equal to \$3,723,245, and a revenue requirement equal to \$2,493,932, an
7 increase over test year revenues of \$913,762, or 57.83 percent.² The cost of
8 improvements necessary to address the systemic odor problem, including the two projects
9 ordered by the Commission, constituted nearly one-half (26.5% of 57.83%) of the
10 Company's requested increase.³ The cost to purchase additional wastewater capacity
11 from the City of Scottsdale contributed almost one-quarter (13.5% of 57.83%) of the
12 requested increase.

13 After accepting several adjustments from Staff and RUCO, and making other
14 adjustments to conform to known and measurable changes, BMSC's Final Schedules
15 reflect a requested finding of fair value rate base equal to \$3,682,905 and a requested
16 revenue requirement equal to \$2,533,172. This requested amount constitutes an increase
17 in revenues of \$953,002, or 60.31 percent. The Company's final proposed rates by class
18 are reflected in BMSC's Final "H" Schedules, as is the Company's proposed Hook-Up
19 Fee tariff. In addition, the Company joins the BHOA in requesting a surcharge to go into
20 effect upon completion of the plant closure project and necessary verification process.

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23 ¹ The key for abbreviations and citations to a witness' pre-filed testimony are set forth in the
24 Table of Abbreviations and Conventions in pages iii to vi above following the Table of Contents.
The table also lists the hearing exhibit numbers of the parties' pre-filed testimony. Other hearing
25 exhibits are cited by the hearing exhibit number and, where applicable, by page number, e.g., R-
26 13 at 2. The transcript of the hearings is cited by page number, e.g., Tr. at 1.

² Bourassa Dt. at Schedule A-1.

³ Sorensen Dt. at 10:1-15.

1 **I. THE RELIEF SOUGHT BY THE BHOA AND BMSC IS IN THE PUBLIC**
2 **INTEREST AND SHOULD BE GRANTED**

3 From the moment public comment opened, the BHOA's and BMSC's joint request
4 for relief dominated the hearings in this rate case, and the extraordinary nature of the issue
5 before the Commission was readily apparent. The first speaker was the Mayor of
6 Carefree, where roughly 75 percent of BMSC's customers reside. Mayor Schwan offered
7 the unequivocal support of the Town and its citizens for the plant closure project and
8 related requests for Commission ratemaking approval.⁴ Customer after customer followed
9 the Mayor extolling the success of BMSC in reducing odors and improving service quality
10 and customer relations.⁵ The Company's success in meeting both the letter and spirit of
11 Decision No. 69164 was unmistakable, as was the fact that such success has now led to
12 another request by the customers to again modify the system to address odors. In addition
13 to the BHOA, which represents roughly 330 customers, support for the plant closure and
14 related rate increase was heard from the neighboring Boulders South HOA (located
15 partially in Scottsdale), and from the approximately 500 supporting letters the
16 Commission received.⁶

17 To add to the extraordinary nature of the issue before the Commission, RUCO
18 turned out to be the sole voice of opposition to the relief requested by a large group of
19 residential ratepayers.⁷ But RUCO's resistance is founded on little more than RUCO's

20 ⁴ Tr. at 10:19 – 12:10. BMSC agrees with the finding in the last rate case that while public
21 comment is not evidence, it is useful information that the Commission considers as an indicator
22 of ratepayer experiences, both positive and negative, with the service provider. Decision No.
23 69164 at 34:24–35:9. The Commission should certainly take note of the overwhelmingly positive
indications from BMSC's ratepayers regarding the success of odor remediation and corporate
cooperation and citizenship. *E.g.*, Tr. at 17:7-11, 23:24-24:2, 25:1-2, 30:14-16, 34:17-19.

24 ⁵ Tr. at 17:7-11, 23:24-24:2, 25:1-2, 30:14-16, 34:17-19.

25 ⁶ Tr. at 26-28, 529; Peterson Dt. at Exhibit B.

26 ⁷ Intervener M.M. Schirtzinger also offered public comment in opposition to the plant closure
project. Tr. at 73-81. The Company respectfully suggests that such comment lacked
identification of a reasonable and prudent alternative to the proposed plant closure.

1 philosophical opposition to adjuster mechanisms.⁸ As RUCO sees it, it's okay to turn a
2 deaf ear to the unanimous voice of hundreds of its constituents because it is RUCO's job
3 to "save the ratepayers from themselves."⁹ According to Mr. Rigsby, RUCO must save
4 BMSC's ratepayers, and every residential ratepayer in the State of Arizona, from the
5 nefarious scheme by the Company and its counsel to obtain precedent for adjuster
6 mechanisms.¹⁰ It's a good thing Mr. Rigsby is "paid to be paranoid."¹¹

7 Obviously, however, RUCO could not deny that the Commission has approved
8 adjusters in other rate cases.¹² RUCO argues that those cases involve "extraordinary"
9 circumstances,¹³ and Mr. Rigsby repeatedly rejected the notion that the request for relief
10 by the BHOA and BMSC constituted unique or extraordinary circumstances.¹⁴
11 Notwithstanding RUCO's fears and philosophies, the record overwhelmingly supports the
12 relief requested.

13 **A. The Problem the BHOA and BMSC are Trying to Solve**

14 There is no dispute in this rate case that the Company has made prudent investment
15 in used and useful plant to address the systemic odor problems identified in the last rate
16 case.¹⁵ While there is no way to prevent odors from sometimes escaping a wastewater
17 transmission and collection system, the Company's plant and operational improvements
18 have eliminated the persistent odor problems that were brought up in the last case, leaving

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20 ⁸ Rigsby Sb. at 4:4-7, 5:8 – 8:19; Tr. at 547:8-548:2.

21 ⁹ Tr. at 527:15-21.

22 ¹⁰ Tr. at 563:1 – 565:15. *See also* Tr. at 530:7 – 532:4. Notably, Mr. Bourassa testified that he
23 did not see this case as establishing any useful precedent due to its extraordinary nature. Tr. at
24 250:11-23. Undersigned counsel would find it very hard to argue with Mr. Bourassa's testimony.

25 ¹¹ Tr. at 565:19.

26 ¹² Rigsby Sb. at 5-8.

¹³ Rigsby Sb. at 8:14-19; Tr. at 521:11-21, 529:7 – 532:1.

¹⁴ Tr. at 521:11-21, 529:7 – 532:1.

¹⁵ *E.g.*, Tr. at 112:20-113:4, 264:16-265:7, 619:17-23.

1 a situation where odors from the collection system can be and are promptly resolved.¹⁶
2 BMSC's wastewater treatment facility in the middle of the Boulders community is another
3 story. The Company has taken proactive steps, such as installing an odor scrubber
4 obtained "used" at low cost from LPSCO. Nevertheless, odors from the plant cannot be
5 eliminated completely,¹⁷ nor can noises, maintenance vehicles coming and going, and the
6 general fact that the community has a treatment plant for a neighbor. These conditions are
7 all consistent with the normal operation of a 120,000 gallon per day treatment plant
8 designed decades ago. While the plant is in full compliance and operating as designed, it
9 is an older facility and, like every wastewater treatment plant, at times it smells. Those
10 times have simply gotten to be too much for the Company's ratepayers.

11 **B. How BMSC and BHOA Propose to Solve the Problem**

12 In order to eliminate odors, noises, traffic, and the general "eyesore," the plant
13 itself has to be removed along with the associated lift station.¹⁸ No party disputes that the
14 plant and lift station are used and useful. Nor does there appear to be a dispute that in
15 order to close the plant the Company will incur costs to (1) remove the existing structure
16 and remediate the property, (2) upgrade the collection and delivery system so that
17 additional flows can safely be delivered to the City of Scottsdale on a permanent basis,
18 and (3) purchase additional treatment capacity from the City to replace the existing
19 capacity.¹⁹ The preliminary estimates place the total cost of this closure project at \$1.5 –
20 \$2 million, or higher, although the cost of the capacity from Scottsdale is fixed at \$6 per
21 gallon, or \$720,000, under BMSC's current contract with the City.²⁰

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23 ¹⁶ Sorensen Rb. at 6:19 – 7:25; Tr. at 131:7 – 132:2, 369:25 – 70:19.

24 ¹⁷ Sorensen Rb. at 6:19 – 7:25; Sorensen Rj. at 7:6 – 8:12.

25 ¹⁸ Sorensen Rj. at 7:15 – 8:3; Tr. at 114:24-115:18, 639:20-640:2, 641:13-24.

26 ¹⁹ Sorensen Rb. at 7:19 – 8:15.

²⁰ *Id.* Tr. at 119:22-120:13, 133:24-134:7.

1 BMSC's shareholder is willing to provide the capital necessary for the plant
2 closure project subject to the terms and conditions set forth in the Settlement Agreement
3 negotiated and entered into following BHOA's intervention in this rate case.²¹ Key
4 among these terms for purposes of this rate case is the provision governing cost recovery.

5 VI. Approval of Cost Recovery for Plant Closure. ACC must approve a
6 cost recovery mechanism that permits BMSC to recover a return on and of
7 the capital costs of closure, which costs include, without limitation, the
8 costs of procuring additional capacity from the City of Scottsdale, the costs
9 of engineering and other analyses necessary to complete the closure, any
10 system upgrades required as a result of the closure and/or the delivery of
11 the flows previously treated at the Plant to the City of Scottsdale. BMSC
12 must also be authorized recovery of any reasonable costs of reaching
13 agreement with the BHOA, the City of Scottsdale and the Resort as
14 required to fulfill the terms of this Agreement, including, without
15 limitation, the costs of obtaining all necessary approval from the ACC,
16 including rate case expense. BMSC shall have no obligation under this
17 Agreement if the ACC does not approve such cost recovery mechanism as
18 acceptable to BMSC in its sole discretion.²²

13 As explained by Liberty Water's senior executive in Arizona, the shareholder is not
14 willing to make the investment to remove used and useful plant and then, after a long
15 delay, face the risk that a future Commission will determine that the Company should not
16 have removed used and useful plant at a cost that could exceed \$2 million.²³ As such, the
17 Company and BHOA have asked the Commission to (1) find in this rate case that the
18 plant closure project is reasonable and prudent and will result in used and useful plant
19 investment; (2) establish a mechanism whereby the costs can be verified as actually
20 incurred and necessary to effectuate the plant closure; and (3) approve a surcharge that
21 will go into effect following the completion of such verification process.

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²¹ Peterson Dt. at Exhibit B.

25 ²² *Id.* at 3.

26 ²³ Tr. at 175:8-20.

1 During the hearing, Mr. Bourassa explained how a surcharge mechanism would
2 work.²⁴ Once the final cost of the plant project is known and measurable, the annual
3 amortization is computed. In his illustration, Mr. Bourassa used 20 years. Then, the
4 return component, gross revenue conversion and incremental income tax factors utilized
5 by the Commission to determine operating income in this case will be applied to
6 determine the additional revenue requirement.²⁵ This additional revenue requirement
7 represents only a return on and of BMSC's investment in the plant closure project at the
8 same rate of return approved in this case. No operating expense increases, including
9 additional costs for treatment by the City, or other costs are sought for recovery through
10 the requested recovery mechanism.²⁶

11 Once the revenue requirement to provide the approved return on and of the
12 Company's investment is determined, that amount is divided by 12 to determine the
13 monthly surcharge recovery requirement.²⁷ That number is then divided by the number of
14 customers, and the result is the monthly surcharge per customer. The same exercise, with
15 additional steps to reflect the reduction in rate base, would be performed after the plant
16 site is sold.²⁸ The Commission may also choose to provide for an annual true-up of the
17 surcharge. That option would require an annual filing by the Company and some analysis
18 by Staff each year, but it would balance the interests of the ratepayers and BMSC by
19 ensuring BMSC only recovers that amount to which it is entitled, no more and no less.²⁹
20 Finally, no surcharge would go into effect until Staff (and the other parties to the extent
21 they choose) have been given a reasonable period (45-60 days) to confirm that the costs

22 ²⁴ Ex. A-11; Tr. at 243:13 – 249:21.

23 ²⁵ Tr. at 245:10 – 246:11.

24 ²⁶ Peterson Dt. at Exhibit B, p. 3; Ex. A-11.

25 ²⁷ Tr. at 246:17 – 23.

26 ²⁸ Ex. A-11.

²⁹ Tr. at 249:4-16.

1 spent were as contemplated and reasonably necessary to accomplish the closure of
2 BMSC's used and useful treatment facility.³⁰

3 Although the circumstances that have led to the joint request for a surcharge by the
4 Company and a host of its ratepayers are extraordinary, there is nothing unusual or
5 complex about the proposed recovery mechanism. In its application, the proposed
6 surcharge is materially similar to the Arsenic Cost Recovery Mechanisms the Commission
7 has approved for other regulated water/sewer providers.³¹

8 **C. Why the Commission Should Approve the Requested Relief**

9 Presumably, RUCO would argue that the fact the relief requested is being
10 compared to the ACRMs gives credence to Mr. Rigsby's anxiety over BMSC and its
11 counsel seeking to take the Commission and residential ratepayers in Arizona down a
12 slippery slope, at the bottom of which is the end of regulation as we know it.³² BMSC
13 would suggest instead that the comparison to the ACRMs simply reflects the fact that the
14 Commission has the tools available to address extraordinary circumstances, and has used
15 such tools to address extraordinary circumstances in the past. Moreover, Mr. Rigsby's
16 fears can be further alleviated by a Commission order making it clear that approval of a
17 surcharge in this case is limited to the unique facts presented and in no way should be
18 considered a precedent for future requests for relief.³³

19 Meanwhile, RUCO does not offer a viable alternative to the relief sought. But
20 RUCO's primary recommendation – that the Commission order BMSC to retire the plant,
21 reroute the flows and purchase more capacity from Scottsdale, then wait one year to see
22

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24 ³⁰ Tr. at 248: 13-22.

25 ³¹ Bourassa Rb. at 30:1-8; Tr. at 248:23 – 249:3.

26 ³² Rigsby Sb. at 7:9-8:19; Tr. at 530:10-531:4.

³³ Tr. at 560:5-21.

1 how operating expenses change, and then come in for a rate case – is severely flawed.³⁴
2 To begin with, it isn't clear that the Commission has the legal authority to order BMSC to
3 remove used and useful plant that is operating exactly as designed and permitted, and is in
4 compliance with all applicable law.

5 In *Southern Pacific*, the court determined that both A.R.S. § 40-321 and A.R.S.
6 § 40-202 (both relied upon by the Commission in Decision No. 69164 as authority for
7 ordering remediation of systemic odor problems) are not authority for the Commission to
8 order a railroad to reinstate a series of discontinued passenger rail services.³⁵ Instead, the
9 court determined that A.R.S. § 40-202 was not intended to give the Commission the
10 ability to “encroach upon the authority to fix the schedules for its train service universally
11 recognized as vested in the railroad management.”³⁶ In fact, Arizona courts have
12 repeatedly held that “while the state may regulate with a view to enforcing reasonable
13 rates and charges, it is not the owner of the property of public utility companies, and is not
14 clothed with the general power of management incident to ownership.”³⁷

15 The retirement of a used and useful and fully compliant treatment facility should
16 likewise be viewed as a decision vested in the utility's management and ownership. This
17 is especially true given that retirement in this case requires an investment of as much as or
18 more than \$2 million. None of the statutes the Commission cited as its authority for
19 ordering remediation of odor problems within BMSC's wastewater system during the last
20 rate case provides any more specificity than A.R.S. § 40-202 or A.R.S. § 40-321; and
21 none expressly authorizes the Commission to order substantial investment in retiring used

22 ³⁴ Rigsby Sb. at 9:1-15; Tr. at 531:7-532:14.

23 ³⁵ *Southern Pacific Co. v. Arizona Corp. Comm'n.*, 98 Ariz. 339, 346-48, 404 P.2d 692, 694
(Ariz. 1965).

24 ³⁶ *Id.* at 348.

25 ³⁷ *Southern Pacific*, 98 Ariz. at 343, 404 P.2d at 694. See also *Phelps Dodge Corp. v. Arizona*
26 *Elec. Power Coop. Inc.*, 207 Ariz. 95, 113, 83 P.3d 573, 591, (Ariz. Ct. App. 2004); *Arizona*
Corp. Comm'n. v. State ex rel. Woods, 171 Ariz. 286, 297, 830 P.2d 807, 818 (Ariz. 1992).

1 and useful plant. “[T]here is no presumption of an attempt on the part of the legislature to
2 interfere with a corporation any further than the public interest requires and no
3 interference will be adjudged by implication beyond the *clear letter* of a statute.”³⁸

4 This debate over the Commission’s authority should not diminish the sincere and
5 important concerns expressed by the Company’s ratepayers, a concern BMSC clearly
6 takes very seriously. Nor is it meant to diminish the Commission’s broad powers. It is
7 simply meant to reflect that there is a reasonable question about whether the Commission
8 can order BMSC to spend millions removing used and useful plant without making
9 provisions for cost recovery. Given this question, coupled with the Company’s
10 willingness to fund the project and the ratepayers’ willingness to pay for it, it is simply
11 unnecessary for the Commission to try to force a remedy on BMSC and its ratepayers
12 based on RUCO’s unsubstantiated fears. That RUCO knows better is simply insufficient
13 reason to thrust the parties into uncertainty and delay.

14 **II. THE CONTRACTUAL SERVICES EXPENSES INCURRED BY BMSC**
15 **ARE REASONABLE AND NECESSARY FOR THE COMPANY TO**
16 **CONTINUE PROVIDING THE HIGHEST LEVEL OF SERVICE AT THE**
17 **LOWEST POSSIBLE COST**

18 **A. Overview of Liberty Water’s Shared Services Model**

19 BMSC does not operate as a stand-alone utility.³⁹ BMSC is operated by Liberty
20 Water, along with six other regulated Arizona water and sewer utilities, and eleven
21 regulated water and sewer providers located in Texas, Missouri and Illinois.⁴⁰ Liberty
22 Water provides all of the day-to-day administration and operations personnel for these

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24 ³⁸ *Id.* (emphasis added); see also *Commercial Life Ins. v. Wright*, 64 Ariz. 129, 166 P.2d 943
(Ariz. 1946) (the powers the Commission may exercise do not exceed those to be “derived from a
strict construction of...implementing statutes.”).

25 ³⁹ *E.g.*, Tr. at 294:16-304:10, 314:19-25.

26 ⁴⁰ Sorensen Dt. at 1:13-21; Sorensen Rj. at 17-19.

1 regulated utilities.⁴¹ All operations and engineering labor is charged by Liberty Water
2 directly to BMSC and the other separate regulated entities operated by Liberty Water.⁴²
3 Liberty Water charges those labor rates at cost, which is the dollar hourly rate per
4 employee as recorded in Liberty Water's payroll system, grossed up for burdens such as
5 payroll taxes, health benefits, retirement plans, and other insurance provided to
6 employees. Engineering technical labor, which is capitalized, is charged on the same
7 basis, plus an allocation for Liberty Water's corporate overheads such as rent,
8 materials/supplies, etc.⁴³

9 Labor for accounting, billing and customer service, human resources, health and
10 safety, cannot be allocated using timesheets due to the nature of the costs. It simply is not
11 practical to keep track of time for employees that serve multiple utilities in small time
12 increments during the course of a work-day.⁴⁴ A shared call center is the perfect example:
13 a customer service representative at Liberty Water's call center will field calls from
14 customers of BMSC, Bella Vista Water Company in southern Arizona and the three other
15 states. This work directly benefits all of the regulated utilities, so the costs need to be
16 allocated to all of them. These costs are allocated based on the relative customer counts
17 of all of the regulated utilities under the Liberty Water umbrella.⁴⁵ Overhead costs, like
18 rent, insurance, administration costs, depreciation of office furniture and computers, also
19 cannot be directly attributed to specific utilities. As such, these are allocated to BMSC
20 and its affiliates by use of a "four factor" methodology that considers relative size through
21 four weighted four factors – total plant, total customers, expenses and labor. This type of
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23 ⁴¹ *Id.* See also Tr. at 329:4-16.

24 ⁴² See Tr. at 392:6-11.

25 ⁴³ See Tr. at 190:4-191:1.

26 ⁴⁴ See Tr. 394:17-395:16.

⁴⁵ See Tr. at 394:11-16, 396:1-18, 397:22-398:21.

1 four-factor methodology has been utilized with Commission approval by other Arizona
2 utilities, including Chaparral City Water Company and Global Water.⁴⁶ All of the costs
3 charged by Liberty Water to BMSC are based on actual costs, either directly charged or
4 through the allocations described above.⁴⁷

5 In addition to the operations and engineering direct costs, and the allocated
6 overhead/administration costs charged by Liberty Water, BMSC and the other utilities in
7 this shared services model also benefit from costs incurred by the Algonquin corporate
8 parent. Specifically, APIF, the shareholder of Liberty Water, allocates a share of the costs
9 of its operating arm, Algonquin Power Trust, a wholly-owned subsidiary like Liberty
10 Water.⁴⁸ APT is the affiliate that provides financial, administrative and support services
11 to the regulated utilities operated by Liberty Water, as well as to the numerous
12 unregulated utility assets owned by the corporate parent, APIF. The head office of APT is
13 located in Oakville, Ontario, and provides administrative, technical and management
14 support, regulatory compliance and budget and accounting control for BMSC and all of
15 the utilities operated by Liberty Water. APT's executive management and administrative
16 support includes accounting and finance, human resources, employee benefits, regulatory
17 and information systems services.⁴⁹ The services provided by APT are necessary to allow
18 BMSC and other regulated utilities to have access to capital markets for capital projects
19 and operations, and are necessary to allow BMSC to provide a high level of service at the
20 lowest cost.

21
22 ⁴⁶ See the Direct Testimony of Marvin E. Millsap, Docket No. W-02113A-07-0551, at 29. See
23 also the Direct Testimony of Gerald Becker, Docket Nos. SW-03575A-09-0077 and SW-
24 20445A-09-0877, at 10-14. Global Water has used a modified four factor methodology in its
current rate case.

25 ⁴⁷ See Tr. at 394:7-16.

26 ⁴⁸ See Tr. at 189:17-23-191:1.

⁴⁹ See Tr. at 189:17-191:1, 196:8-14.

1 There are no direct labor costs included in the Corporate Administration Cost
2 allocation. Instead, these costs include professional services like third-party legal,
3 accounting, tax, and auditing that are done, for the benefit of all of the Liberty Water
4 regulated utilities and the numerous other facilities under the Algonquin corporate
5 umbrella. These corporate headquarter costs also include costs for licenses, fees and
6 permits, IT, Payroll, and HRIS maintenance contracts, as well as the rent and depreciation
7 of office furniture and equipment and computers in the central office. These costs are
8 allocated to BMSC, and each of the other utilities, facilities and plants owned and
9 operated by APIF. The allocation is made based on relative size. To start, there are 63
10 total entities owned and operated by APIF, 17 of which are the regulated utilities operated
11 by Liberty Water. 17 of 63 is 26.98 percent, and 26.98 percent of the total allocated costs
12 are pushed down to Liberty Water. From there, Liberty Water allocates the costs between
13 BMSC and the 16 other regulated utilities based on customer counts. These costs are not
14 capable of being directly charged to the 63 separate operating assets. But they are
15 incurred for the benefit of all of the regulated utilities and their customers. This cost
16 allocation methodology ensures that the costs are allocated as closely as possible to the
17 cost causer. It stands to reason that an entity such as LPSCO with 16,000 water and sewer
18 customers benefits more from these costs than BMSC with only 2,000 wastewater
19 ratepayers. In fact, the undisputed evidence is that, even if these costs could somehow be
20 directly charged, it would show little difference relative to the customer-count based
21 allocation methodology.

22 None of the intervenors, including RUCO, recommends adjustment to any of the
23 costs charged by APIF/APT or Liberty Water. Staff does not make adjustment to the
24 Liberty Water charges included in the test year, however, as explained below, Staff
25 inexplicably rejects known and measurable increases in these costs. Staff also rejects over
26 90 percent of the cost allocation by APIF/APT and recommends a new allocation

1 computation for these costs. BMSC suggests that Staff's position reflects either a
2 fundamental misunderstanding of the manner in which BMSC is owned and operated, or a
3 fundamental disagreement on what goes into providing adequate and reliable utility
4 service. Or both. In the end though, the evidence simply does not support Staff's
5 adjustments.

6 **B. Response to Staff's Recommended Adjustments**

7 1. Liberty Water Allocated Cost Increase

8 In its direct filing, BMSC proposed an adjustment to recognize known and
9 measurable changes to the allocated portion of operations, accounting and billing and
10 other corporate overhead costs.⁵⁰ This adjustment initially increased operating expenses
11 by \$50,302 over the test year; however, the contractual services expense level was later
12 reduced to \$44,018 by a BMSC rebuttal adjustment.⁵¹ Staff rejected the adjustment
13 without explanation other than saying that "the increases were not justified."⁵² Staff never
14 really explains what is unjustified about an adjustment that is made to account for known
15 and measurable changes to payroll expense, including the annualization of (1) additional
16 labor costs from annualization of salaries and wages to a full 12 months; (2) additional
17 labor costs from annualization of pay increases that occurred during the test year; and
18 (3) the cost of additional employees hired after the end of the test year for vacant positions
19 existing during the test year.⁵³ "The annualization of salaries and wages is necessary
20 because the test year included less than a full 12 months of wages for several employees.
21 The pay increases are necessary because they reflect payroll costs of employees on a
22 going forward basis."⁵⁴

23 ⁵⁰ Bourassa Dt. at 14:15-17 and Schedule C-2, page 12.

24 ⁵¹ Bourassa Rb. at 23:15-21.

25 ⁵² Brown Dt. at 18:10-25.

26 ⁵³ Bourassa Rb. at 24:1-21.

⁵⁴ *Id.*

1 In this case, the annualized labor costs include costs for Liberty Water's Manager
2 of Safety and Regulatory Matters, a Customer Service Representative, a Budget Analyst,
3 and a Business and Strategic Planning Analyst.⁵⁵ Although Staff recognized in surrebuttal
4 that the Company's adjustments arise from the annualization of these wages and salaries,
5 Ms. Brown continued to recommend disallowance because the labor costs are part of
6 Liberty Water's shared services model.⁵⁶ Yet, Ms. Brown did not recommend disallowing
7 any other costs charged by Liberty Water, including allocated shared personnel costs
8 incurred at the Liberty Water level. Nor did Staff explain why these annualized costs are
9 distinguishable. In short, the adjustment to the test year level constitutes a known and
10 measurable change to costs already found reasonable, which means the Company's
11 adjustment is, by definition, justified.

12 2. Central Cost Allocation

13 During the test year, the total Central Office cost allocation pool was an adjusted
14 \$3.94 million of administration costs.⁵⁷ The Company's proposed expense level for the
15 Central Cost allocation to BMSC is \$33,778, or less than one tenth of one percent of the
16 total pool.⁵⁸ This amount was determined according to the APIF/APT methodology
17 introduced above. The total pool is first allocated to APIF's Utility Infrastructure Group,
18 aka Liberty Water, with 26.98 percent or \$1,062,190 being allocated to Liberty Water,
19 with the remaining 73.02 percent allocated to the Power Group.⁵⁹ This means that nearly
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21 ⁵⁵ Bourassa Rb. at 24:17-21.

22 ⁵⁶ Brown Sb. at 31:19-22.

23 ⁵⁷ Bourassa Rb. at 18:4-10. This amount reflects BMSC's acceptance of Staff's reduction of
24 \$191,828 (Schedule CSB-17) for disallowed costs. The Company accepts that these amounts,
25 which include, among other things, charitable contributions and corporate gifts, while part of any
26 large corporation's expenses, may not be viewed as a direct enough benefit to ratepayers. Tr. at
189:11-16.

⁵⁸ BMSC Final Schedule C-2, page 16.

⁵⁹ Bourassa Rb. at 18:10-15.

1 three-quarters of the total cost allocation pool is charged to BMSC's non-regulated
2 affiliates. From there, Liberty Water allocates that 26.98% of costs between its separate
3 regulated utilities based on relative customer count. BMSC's share of the allocation pool
4 pushed down to Liberty Water during the test year is just over 3 percent.⁶⁰

5 The Company has provided substantial evidence of the benefit of these costs.⁶¹
6 The benefits of these services and costs to the regulated utilities and their ratepayers also
7 are self-evident. APIF's primary business is ownership of generating and infrastructure
8 facilities through investments in securities of subsidiaries. APIF owns operating interests
9 in 46 power facilities and 17 water distribution and wastewater treatment facilities in the
10 United States. APIF is publicly traded on the Toronto Stock Exchange. APIF's structure
11 as a publicly traded income fund provides substantial benefits to its regulated utilities and
12 their customers through access to capital markets and access to engineers, technicians,
13 professional managers and administrative staff. Put simply, the services provided by APT
14 allow the utilities, including BMSC, to provide a higher level of utility service to
15 customers at the lowest possible cost. The track record of APIF's regulated utilities in
16 Arizona in providing high quality utility service illustrates the benefits of allocating these
17 Central Office Administration costs to BMSC and the other utilities. Absent such cost
18 allocation, BMSC and the other Arizona utilities would not have access to the strategic
19 management, financial, administrative, and other services provided by APT in order to
20 optimize the performance of the utilities and ensure ongoing access to capital.

21 Undoubtedly, when viewed on a cost-by-cost basis, it might appear that a small
22 company like BMSC could operate without some of the services provided to it;⁶²

23 ⁶⁰ Bourassa Rb. at 18:15-18.

24 ⁶¹ Bourassa Rb. at 18-23; Bourassa Rj. at 23-27.

25 ⁶² Of course, the small utility argument also does not explain why Staff has made the exact same
26 recommendation in the pending LPSCO rate case. (See the Direct Testimony of Jeffrey M. Michlik for Water Division, Docket No. W-01427A-09-0103 *et al.*, at 17-19.) LPSCO is roughly 16 times the size of BMSC.

1 however, each of those services also undoubtedly help BMSC achieve benefits that more
2 than offset the costs. Further, this is not an appropriate standard of comparison unless the
3 goal is to reach the bare minimum service level.⁶³ As Staff testified in BMSC's last rate
4 case, and has testified in this case, an entity like Liberty Water can only operate prudently
5 if it uses a shared services model.⁶⁴

6 Put bluntly, Staff's nominal 10 percent of the total allowed cost allocation pool to
7 be recovered through rates has 1) has not been substantiated by staff, and 2) is effectively
8 a rejection of one pillar of the APIF/APT/Liberty Water shared services model. If the
9 Liberty Water's shared services model is not viewed as reasonable because of its costs,
10 then Liberty Water will have to seriously consider operating the utilities on a standalone
11 basis with standalone costs that are sure to outweigh the costs proposed in this case. It's
12 certainly unlikely to be continued if 90 percent of an over \$1 million allocation pool to the
13 seven Arizona utilities is disallowed. One can't help but wonder why Staff would reject a
14 shared services model that is designed to deliver high quality utility service at the lowest
15 possible price given numerous failed utility operations in Arizona, including Arizona
16 Utility Supply & Services, Desert Hills Water Company and the infamous McLain
17 systems.⁶⁵ The notion, as Staff suggests, that these allocated costs from the parent do not
18 benefit the ratepayers is undercut by the very high level of service BMSC is providing to
19 customers in this system. BMSC and other regulated utilities can only provide such high
20 quality service and capital funding because of the strategic management, audit, tax
21 planning, and other administrative services provided by APT.

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24 ⁶³ Tr. at 197:18-198:13.

25 ⁶⁴ Tr. at 773:1-5, 775:8-15.

26 ⁶⁵ Decision No. 67201 (August 18, 2004); Decision No. 68780 (June 19, 2006); and Decision No. 66241 (September 16, 2003).

1 Staff's recommendation to deny allocation of those costs necessarily will mean that
2 the level of service provided to customers will decline. For example, planning of capital
3 projects could be eliminated for the Black Mountain service territory. Staff should
4 encourage this type of cost effective, high quality service, rather than penalize it. As the
5 old saying goes, Staff will have some explaining to do with the ratepayers, who are not
6 complaining in any way about the rates they are paying for service, when the quality of
7 service inevitably declines. Again, it's simple business reality – if you are doing
8 something prudent but can't recover the costs, you are not being given the opportunity to
9 earn a return on your investment. The only remedy the utility will have will be to cut
10 costs by reducing service levels. Only Staff seeks to have BMSC provide service in a
11 different manner in this case, but Staff's reasons just don't stack up.

12 3. Performance Incentive Based Pay

13 The third contractual service expense issue in dispute between the Company and
14 Staff is Staff's opposition to what Staff calls "bonuses" and what the Company calls "at-
15 risk" or performance based pay. Staff's position is consistent with what now looks like a
16 fundamental rejection by Staff of the manner in which Liberty Water operates. As
17 explained by Mr. Sorensen, customers are not harmed because a Liberty Water employee
18 is paid a salary of \$42,000 with the opportunity to earn a \$3,000 "bonus" for performance,
19 instead of simply being paid \$45,000 in annual salary.⁶⁶ Liberty Water has actually found
20 that this compensation system improves overall employee performance, a benefit to
21 ratepayers since that higher performance is being delivered at no higher cost.⁶⁷ This is not
22 to say that "bonuses" are not areas for potential abuse; BMSC accepts that they are. But
23 Ms. Brown does not testify that the Company has abused the process by, for example,
24 paying Mr. Sorensen a bonus equal to 50 percent of his salary and then hoping ratepayers

25 ⁶⁶ Sorensen Rj. at 14:3-10.

26 ⁶⁷ *Id.*; Tr. at 764:17-766:5.

1 pick up the tab. Rather, Staff simply appears to have a fundamental problem with the
2 methodology. In fact, Staff believes that it is more justifiable from a rates perspective to
3 pay an employee a \$45,000 salary rather than a \$42,000 and a \$3,000 performance
4 incentive⁶⁸. Staff's suggestions would provide a disincentive for employees to continually
5 strive for improvement.

6 In summary, the benefits of this performance based pay structure are a reflection of
7 fundamental economic principles. Put simply, the classic carrot on a stick. If you pay
8 employees with a performance bonus, those employees inevitably will work harder for the
9 company and customers. At the same time, there is no negative impact on customers.

10 **III. RATE BASE AND INCOME STATEMENT ISSUES IN DISPUTE**

11 **A. Brief Summary of Issues Resolved Post-Hearing**

12 Throughout the proceedings, the parties were successful in narrowing issues in
13 dispute.⁶⁹ After the hearings, two additional issues were resolved between Staff and the
14 Company when BMSC provided additional information to Staff. Specifically, BMSC
15 provided Staff an invoice to verify the costs of the odor scrubber, and Staff's Final
16 Schedules reflect the inclusion of odor scrubber in BMSC's plant in service at a cost of
17 \$38,250.⁷⁰ In addition, before agreeing to include test year costs from the vendor Aerotek
18 in BMSC's operating expenses, Staff wanted to verify that such costs have been removed
19 from LPSCO's books in its pending rate case. LPSCO has made this change, the
20 Company has provided this information to Staff, and Staff has included these costs in
21 BMSC's operating expenses.⁷¹ Thus, there is no longer an odor-scrubber or Aerotek issue
22 in dispute.

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24 ⁶⁸ Tr. at 767:3-22.

25 ⁶⁹ E.g., Moore Sb. at 2:13 – 3:11; Brown Sb. at 3:24-4:9; 20:19-21:8.

26 ⁷⁰ See Ex. A-16 and Staff Final Schedule CSB-5.

⁷¹ See Ex. A-19 and Staff Final Schedule CSB-18.

1 **B. Issues in Dispute with RUCO**

2 1. Non-Recurring Expenses

3 During the test year, the Company incurred \$39,870 remediating an unauthorized
4 discharge of wastewater.⁷² Such discharges, while regrettable, are part of the operation of
5 a sewer utility system.⁷³ The Company responded rapidly, its remediation was completed,
6 and there were no citations or other adverse findings by any regulatory agency.⁷⁴

7 Staff recommended normalizing this expense over a three-year period.⁷⁵ Because
8 these “spill” events are impossible to predict, the Company accepted Staff’s adjustment as
9 a reasonable reflection of the amount of costs the Company could expect to incur during
10 the period the rates will be in effect.⁷⁶ RUCO does not. According to RUCO, the costs
11 were incurred due to the failure of the Company to adequately provide service, therefore,
12 they should be borne exclusively by the shareholder.⁷⁷ But RUCO offers no evidence and
13 there is none in the record demonstrating that unauthorized discharge and the subsequent
14 remediation costs resulted from error, negligence or malfeasance by the Company.⁷⁸
15 Again, these things happen on occasion in the ordinary operation of a wastewater
16 collection, transmission and treatment system. The Company did everything it was
17 supposed to do, and a reasonable level of operating expense reflects the necessity of
18 incurring this cost in the provision of service.

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⁷² Brown Dt. at 19:24-20:12.
⁷³ Sorensen Rj. at 6:1-15.
⁷⁴ Sorensen Rj. 6:10-15; Tr. at 405:20-406:2.
⁷⁵ Brown Dt. at 19:24-20:2.
⁷⁶ Bourassa Rb. 14:8-20; Sorensen Rb. at 12:20 – 13:3.
⁷⁷ Moore Sb. at 11:18-23.
⁷⁸ Tr. at 489:18 – 492:9.

1 2. Bad Debt Expense

2 Staff and BMSC propose bad debt expense of \$14,377.⁷⁹ This amount reflects
3 write-offs of test year revenues, whether those write-offs were completed during or after
4 the test year.⁸⁰ RUCO opposes this level of bad debt expense and recommends its own.
5 The only position RUCO stated in its prefiled testimony was that RUCO has not altered
6 its position and does not recommend an adjustment.⁸¹ At trial, Mr. Moore simply testified
7 that he felt his position was reasonable.⁸² But RUCO has not provided any evidence that
8 its position is “normal,” nor has it rebutted the evidence presented by Staff and BMSC
9 that their recommended level of bad debt expense reflects all of the known and
10 measurable write-offs of test year revenues.

11 C. Issues in Dispute with Staff

12 1. Accumulated Deferred Income Taxes

13 “Accumulated deferred income taxes (“ADIT”) reflect the timing differences
14 between when income taxes are calculated for ratemaking purposes and the actual federal
15 and state income taxes paid by the Company.”⁸³ These timing differences occur primarily
16 from differences in depreciation methods. Net ADIT liabilities are a deduction to rate
17 base, and net ADIT assets are an addition to rate base. As Staff’s witness Crystal Brown
18 testified in the last rate case, SFAS 109 requires the use of deferred tax accounting to
19 recognize these income tax timing differences.⁸⁴

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22 ⁷⁹ BMSC Final Schedule C-1, page 1.
23 ⁸⁰ Bourassa Rb. at 16:1-14; Brown Supp. Sb. at 5:21-6:6.
24 ⁸¹ Moore Sb. at 5:8-9.
25 ⁸² Tr. at 473:16-23, 494:15-23.
26 ⁸³ Decision No. 69164 at 12-15. *See also* Brown Sb. at 6:19 – 8:1.
 ⁸⁴ Decision No. 69164 at 5:15-20. *See also* Brown Sb. at 6:19 – 8:1.

1 Accordingly, in its direct filing, the Company increased rate base to account for a
2 net ADIT asset equal to \$170,554.⁸⁵ Then, in rebuttal, Mr. Bourassa adjusted his
3 calculation of ADITs to account for adjustments to plant in service, accumulated
4 depreciation and AIAC.⁸⁶ The Company's rebuttal schedules reflected a net ADIT asset
5 of \$194,898. Finally, in order to conform to additional changes in the accumulated
6 depreciation balance, Mr. Bourassa increased the ADIT asset by \$1,008 to \$195,906.⁸⁷
7 Reflecting the Company's final PIS, A/D, CIAC and AIAC, the ADIT is slightly higher in
8 the Company's Final Schedules at \$196,009 due to the use of the final cost for the odor
9 scrubber.⁸⁸

10 Initially, neither Staff nor RUCO objected to the Company's calculation of an
11 ADIT asset and the addition to rate base; and no adjustment is found in their direct
12 schedules.⁸⁹ Then, in surrebuttal, RUCO affirmatively accepted the Company's
13 "conforming" change to the ADIT asset and agreed to an addition to rate base of
14 \$194,898.⁹⁰ Staff, on the other hand, concluded that something must be amiss because
15 ADITs are "normally" negative, a deduction to rate base.⁹¹ In this case, what Ms. Brown
16 claimed she found wrong was the incorrect inclusion of AIAC from "service
17 connections."⁹² As a result, Staff reduced the Company's rate base by \$170,000 and
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20 ⁸⁵ Bourassa at Dt. at Schedule B-2, p. 7.

21 ⁸⁶ Bourassa Rb. at 8:1-8 and Schedule B-2, page 2.

22 ⁸⁷ Bourassa Rj. at 6.

23 ⁸⁸ Final Schedule B-2, page 2 and page 6.

24 ⁸⁹ Staff Schedule CSB-4; RUCO Schedule RLM-2.

25 ⁹⁰ Moore Sb. at 8 and Schedule RLM-2.

26 ⁹¹ Brown Sb. at 8:2-19.

⁹² Brown Sb. at 9:1-5.

1 reduced the ADITs to zero.⁹³ This adjustment is contrary to SFAS 109, which Ms. Brown
2 testified in the last rate case requires recognition of the Company's ADITs.⁹⁴

3 In response to Staff's position, BMSC pointed out that it does not have service
4 connections, therefore, such AIAC could not have been included in the ADIT
5 calculation.⁹⁵ Mr. Bourassa also explained that the Commission had already found
6 "[w]hether other utilities normally report net deferred tax liabilities is not a controlling
7 factor . . ."⁹⁶ He also explained, as the Commission also recognized in the last rate case,
8 that when there are significant amounts of AIAC and/or CIAC funded plant, net ADIT
9 assets are more common.⁹⁷ In other words, Staff's surrebuttal position on ADITs was
10 both, in error, and contrary to the decision in the last rate case for BMSC.

11 After the hearings commenced, Staff filed Ms. Brown's supplemental surrebuttal
12 testimony.⁹⁸ Staff does not mention the Company's rejoinder filing or the additional
13 information in Mr. Bourassa's rejoinder, which testimony was responsive to Ms. Brown's
14 surrebuttal testimony. Instead, in this supplemental testimony, Ms. Brown merely
15 asserted for the first time that the Company had not provided adequate documentation for
16 its ADIT calculation.⁹⁹ During the hearing, Ms. Brown admitted that the Company's
17 ADIT calculation did not erroneously include AIAC, as previously asserted, and that
18 Mr. Bourassa's calculation methodology was entirely consistent with Decision No. 69164
19 and SFAS 109.¹⁰⁰ As for the alleged inadequacy, Ms. Brown testified that she wanted the

20 ⁹³ Brown Sb. at 12-15.

21 ⁹⁴ Decision No. 69164 at 5:13-19.

22 ⁹⁵ Bourassa Rj. at 9-10.

23 ⁹⁶ Decision No. 69164 at 6:7-8 rejecting RUCO's argument that the Company cannot have an
ADIT asset because ADIT are "unfailingly" negative. *See also* Bourassa Rj. at 7-8.

24 ⁹⁷ Bourassa Rj. at 7:13-8:2 *citing* Decision No. 69164 at 6:11-13.

25 ⁹⁸ No request was made by Staff to make this additional and untimely filing.

26 ⁹⁹ Brown Supp Sb. at 16-23.

¹⁰⁰ Tr. at 702:3-7, 739:21-740:13.

1 2008 tax depreciation schedule and reconciliation so she could verify the ADIT
2 calculation.¹⁰¹

3 This has been a very difficult issue for the Company. This is not to say that BMSC
4 and its counsel do not sympathize with the Commission's heavy caseload. But this
5 caseload cannot be allowed to diminish the Company's opportunity to present its case and
6 defend against the positions of others, all of which is fundamental to due process. In
7 addition to Staff's moving target position on the ADIT issue, Ms. Brown simply never
8 asked for the 2008 tax depreciation schedule.¹⁰² Nor did the Company have any reason to
9 believe she needed it given that the filing was based on a June 30, 2008 test year and the
10 Company had already provided all of the information necessary to reconcile its calculation
11 of ADITs to June 30, 2008. Nevertheless, immediately after trial, the Company provided
12 Staff with the 2008 tax depreciation schedule and the requested reconciliation.¹⁰³ As these
13 documents show, Mr. Bourassa's ADIT calculation is significantly understated, if
14 reconciled to year-end 2008. Still, the Company's position has not changed, and it should
15 be adopted because there is no substantial evidence to rebut the Company's proposed net
16 ADIT asset of \$196,009.

17 2. Working Capital

18 The preferred means of determining cash working capital is a lead/lag study.
19 Lead/lag studies are time consuming to prepare and, as such, increase rate case expense.
20 Lead/lag studies are also often the subject of dispute, which further increases rate case
21 expense. For these reasons, the Company chose not to request any working capital

22 ¹⁰¹ Tr. at 740:14-22, 743:13-745:20.

23 ¹⁰² Tr. at 744:22-745:20.

24 ¹⁰³ Exs. A-17 and A-18. As reflected in the Company's December 10, 2009 Notice of Filing,
25 Staff does not object to these exhibits if Judge Nodes finds them useful. Given that Ms. Brown
26 testified at trial she needed them, they would appear to have at least been useful to Staff's
witness. They are certainly useful to the Company in confirming the accuracy of its ADIT
calculation, which, if anything, is now known to be understated.

1 allowance.¹⁰⁴ RUCO agrees that a zero working capital allowance is appropriate in this
2 case.¹⁰⁵ Staff does not agree, and recommends negative working capital in the amount of
3 \$75,980 (negative \$83,132 cash working capital less \$7,152 of prepayments), a deduction
4 to rate base.¹⁰⁶ However, Staff's lead/lag analysis suffers from several flaws.

5 First, Staff presented no testimony or analysis in support of initial position on
6 working capital. Instead, Ms. Brown simply testified that Staff used the same
7 methodology as in the last rate case and came up with a negative cash working capital of
8 \$127,213.¹⁰⁷ But what Staff really did was estimate leads and lags for BMSC using
9 generalized estimates similar to the last rate case.¹⁰⁸ All Schedule CSB-9 showed was an
10 estimate of one component of working capital, the cash component. Staff also ignored
11 materials and supplies and prepayments, the inclusion of which would have lowered
12 Staff's estimated working capital by more than \$17,000.¹⁰⁹

13 Second, by recommending a significant adjustment to reflect negative cash
14 working capital based solely on estimates, Staff placed BMSC in the position of having to
15 prepare its own lead lag study to show the flaws in Staff's recommendation.¹¹⁰ In other
16 words, the dispute Mr. Bourassa had sought to avoid in the first place was now present. In
17 any event, Mr. Bourassa's lead-lag study using actual Company data and payment
18 practices led to the determination of a positive working capital allowance equal to
19 \$13,544.¹¹¹

20 _____
21 ¹⁰⁴ Bourassa Dt. at 5:17-22; Bourassa Rb. at 8:17-9:7; Bourassa Rj. at 10:20 – 11:6.

22 ¹⁰⁵ Moore Sb. at 4:3-4.

23 ¹⁰⁶ Staff Final Schedule CSB-3.

24 ¹⁰⁷ Brown Dt. at 11:9-25.

25 ¹⁰⁸ Bourassa Rb. at 9:10-19.

26 ¹⁰⁹ *Id.*

¹¹⁰ Bourassa Rb. at 8:16 – 17:7.

¹¹¹ Bourassa Rb. at 9:2-5. *See* BMSC Final Schedule B-5.

1 Third, Staff has not corrected the numerous flaws in its recommendation. For one
2 thing, there is still no lead-lag study from Staff to support its recommendation. Instead,
3 all Staff did to defend its recommendation on surrebuttal was modify Mr. Bourassa's
4 revenue and expense leads and lags based on Ms. Brown's subjective views of the time
5 periods.¹¹² Furthermore, Staff's modified lead-lag "study" used a materially understated
6 number of revenue lag days,¹¹³ overstated expense lag days for property taxes,¹¹⁴ double
7 counted interest expense,¹¹⁵ failed to use actual expense practices of BMSC and excluded
8 rate case expense, which is paid up front¹¹⁶ yet recovered over several years following its
9 incurrence.¹¹⁷ These flaws further overstate Staff's deduction to rate base for cash
10 working capital.

11 Given the lack of evidence in support of Staff's recommendation, a zero working
12 capital allowance is not only fair and reasonable, it is also more favorable to the
13 ratepayers than the only determination in this case that is actually supported by substantial
14 evidence, which is Mr. Bourassa's lead/lag study.

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18 ¹¹² Bourassa Rb. at 11:11-18.

19 ¹¹³ Staff testifies that it averaged the revenue lag days from the last case with the Company's
20 computed revenue lag days in the current case to produce 9.6 days. See Brown Sb. at 15.
21 However, in its final schedules, Staff computed 8.88 days. See Staff Final Schedule CSB-10.
22 The 8.88 revenue lag days is not supported by the Company's customer payment information that
23 Staff asserts it used. Using the customer payment data and following the method used in the last
24 case which measures the payment lag from the mid-point of the service period to the payment
25 date, Mr. Bourassa computed revenue lag days of 12.87. See Bourassa Rj. at 14.

26 ¹¹⁴ Bourassa Rj. at 18. Staff uses 212 days, but the evidence shows the Company actual payment
information reflects 154.5 days.

¹¹⁵ Staff corrected this flaw in its final schedules.

¹¹⁶ Bourassa Rj. at 19.

¹¹⁷ Bourassa Rj. at 11:14-19:16. Staff did correct the double count of interest expense in its
supplemental surrebuttal. Brown Supp. Sb. at 5:1-4.

1 3. Transportation Expense

2 BMSC has a truck used solely in the provision of wastewater utility service by
3 BMSC.¹¹⁸ Only employees of Liberty Water that provide operation and maintenance
4 services to BMSC use it. Nevertheless, Staff recommends disallowance of the
5 transportation expense related to this truck because it is leased in the name of BMSC's
6 affiliate, Gold Canyon Sewer.¹¹⁹ Mr. Sorensen explained that this was simply due to
7 GCSC's existing relationship with a fleet dealer that made the lease of the vehicle in
8 GCSC's name more efficient.¹²⁰ Nevertheless, Ms. Brown claimed that the fact that the
9 truck was in GCSC's name meant it could be shared with GCSC, or worse, reassigned to
10 GCSC then included in GCSC's next rate case.¹²¹ Accordingly, Ms. Brown claims the
11 Company should have had mileage logs. However, the vehicle is used only for BMSC,
12 thus a log would merely show what is already known. Moreover, the name on the lease
13 does not make it any more likely that BMSC will share the truck with GCSC than it will
14 share the truck with LPSCO, whose name is not on the title but which is actually located
15 in the same county as BMSC. Again, the only evidence in the record is that the truck is
16 BMSC's and not shared with any other utility.

17 **D. Rate Case Expense-An Issue in Dispute with Both Staff and RUCO**

18 BMSC initially estimated \$180,000 of rate case expense when it filed its
19 application.¹²² The Company's estimate was based on the expertise of its consultant,
20 Mr. Bourassa with due consideration to the anticipated issues and process for a
21 Commission rate case for a Class B sewer utility.¹²³ Then, at the rebuttal stage of the

22 ¹¹⁸ Sorensen Rb. at 15:12-16:6; Sorensen Rj. at 15.

23 ¹¹⁹ Brown Dt. at 22.

24 ¹²⁰ Sorensen Rb. at 15:15-17.

25 ¹²¹ Brown Sb. at 32:18-25.

26 ¹²² Bourassa Dt. at 12:19 – 13:13.

¹²³ *Id.*

1 proceeding, the Company increased its estimate of rate case expense by \$50,000 to
2 account for the additional fees incurred and to be incurred as a result of the BHOA's
3 intervention.¹²⁴ Finally, during the hearing, Mr. Bourassa provided an updated estimate at
4 RUCO's request. Based on the fees incurred to date and the estimated costs to conclusion
5 of the rate case, Mr. Bourassa testified that the Company was reducing its final requested
6 rate case amount to \$220,000.¹²⁵

7 No party opposed the Company's request for rate case expense until after the
8 hearing started and Staff filed Ms. Brown's supplemental surrebuttal testimony.
9 Previously, in its direct filing Staff was silent on the issue. Then in surrebuttal,
10 Ms. Brown testified that she agreed with the Company's request for increased rate case
11 expense and would undertake to verify the additional expenses prior to hearing.¹²⁶ It came
12 as quite a surprise, therefore, when Staff filed Ms. Brown's testimony rejecting the
13 additional rate case expense because the costs related to the settlement agreement were
14 "not pertinent" to this rate case.¹²⁷ This position makes little sense.

15 To begin with, settlement with a party to a rate case is clearly relevant to the rate
16 case. A determination otherwise would discourage utilities from trying to resolve issues
17 in dispute, such as the Company did in this case with an intervenor representing a
18 significant number of its customers. Moreover, the BHOA's intervention is not limited to
19 the settlement agreement. Instead, as a result of the intervention, additional claims for
20 relief were brought and adjudicated. The BHOA's intervention would have occurred and
21 caused BMSC to incur additional rate case expense with or without the settlement; but it
22 was probably less costly with the settlement because the Company and its customers were

23 _____
24 ¹²⁴ Bourassa Rb. at 25:4-15.

25 ¹²⁵ Tr. at 239:17-242:3.

26 ¹²⁶ Brown Sb. at 23:16-24:6.

¹²⁷ Brown Supp. Sb. at 6:8-18.

1 not at odds on the most contentious issue in this rate case. In short, the BHOA's
2 intervention is hardly irrelevant to this rate case and the additional costs as a result should
3 be recovered. Even the BHOA agrees.¹²⁸

4 Like Staff, RUCO now also recommends \$180,000 in rate case expense. However,
5 RUCO has not offered a shred of evidence in support of its position. Its witness was silent
6 on the issue in his direct testimony, merely stating in surrebuttal that RUCO would
7 address the issue later.¹²⁹ Even at hearing when asked what RUCO's position was, its
8 witnesses could provide no answer and no evidence to supports its position, whatever it
9 would be.¹³⁰ Obviously the Company cannot defend again a position offered without
10 support, except to state that the Company's request for rate case expense in the amount of
11 \$220,000 amortized over three years is reasonable and supported by the evidence in the
12 record.

13 **IV. COST OF CAPITAL**

14 **A. Capital Structure: Nothing Has Changed, Including RUCO's** 15 **Arguments**

16 BMSC has an actual capital structure of 21.6 percent debt and 78.4 percent
17 equity.¹³¹ However, for ratemaking purposes, the Commission directed 13 years ago that
18 the debt in the Company's actual capital structure be ignored for ratemaking purposes.¹³²
19 The Commission also followed this same ratemaking treatment of the Company's debt in
20 the last rate case.¹³³ Consistent with this decade old ratemaking treatment, both Staff and
21

22 ¹²⁸ Peterson Dt. at 9-11.

23 ¹²⁹ Moore Sb. at 5:10-12.

24 ¹³⁰ Tr. at 479:15 – 482:9, 502:3-15.

25 ¹³¹ Manrique Dt. at 6:16-20.

26 ¹³² Manrique Dt. at 6:19-20 *citing* Decision No. 59944 (December 26, 1996).

¹³³ Decision No. 69164 at 20:16-17.

1 BMSC propose to continue ignoring the actual debt in the Company's actual capital
2 structure and to use a 100 equity capital structure.¹³⁴

3 In contrast, as it did in the last rate case, RUCO seeks to use the past ratemaking
4 treatment ordered by the Commission as a springboard to impose a hypothetical capital
5 structure on the Company. RUCO prefers a hypothetical capital structure to the
6 Commission's usual use of the Hamada adjustment because RUCO's recommended
7 hypothetical capital structure also contains an additional adjustment to account for
8 fictitious debt cost and interest expense deductions.¹³⁵ RUCO's position isn't surprising,
9 the use of interest synchronization with RUCO's recommended debt and equity costs
10 leaves BMSC without an adequate opportunity to earn RUCO's already very low effective
11 rate of return of only 7.43 percent.¹³⁶ This would have a severe impact on the ability of
12 BMSC to attract capital in Arizona.¹³⁷

13 Because of this, in the last BMSC decision, the Commission rejected RUCO's
14 proposed hypothetical capital structure as "results oriented" and "not consistent" with the
15 Company's actual capital structure.¹³⁸ RUCO chose not to appeal this clear holding, but
16 now asks the Commission to essentially overrule more than a decade of ratemaking
17 treatment for BMSC.¹³⁹ Yet, RUCO offers no evidence supporting a change in
18 ratemaking treatment for BMSC, and there is simply no basis for deviating from past
19 rulings. In this case, the only thing that RUCO claims is different is the Commission's
20 recent decision for BMSC's affiliate, GCSC, in which a hypothetical capital structure was

21
22 ¹³⁴ Manrique Dt. at 6:12-14.

23 ¹³⁵ Tr. at 512:8-20.

24 ¹³⁶ Sorensen Rb. at 10:8-22.

25 ¹³⁷ Sorensen Rb. at 10:17-22.

26 ¹³⁸ Decision No. 69164 at 20:14-17.

¹³⁹ Tr. at 588:13-15.

1 approved in order to reduce the amount of the rate increase.¹⁴⁰ RUCO's attempt to use the
2 GCSC decision to support its recommended hypothetical capital structure is disingenuous.
3 When the Company compared the two decisions in the appeal of the GCSC decision,
4 RUCO specifically argued to the court that BMSC is "clearly distinguishable" from
5 GCSC "based on size, customer connections, operating income, revenues, expenses and
6 rate base."¹⁴¹ Although Mr. Rigsby testified he was unaware of RUCO's arguments on
7 appeal, this does not change the fact that RUCO is arguing one thing to the Court of
8 Appeals and another to this Commission. This is simply one more reason RUCO's
9 recommended hypothetical capital structure must again be rejected by the Commission for
10 BMSC.

11 **B. RUCO's and Staff's Recommended ROEs Will Make it Very Hard for**
12 **BMSC to Attract Capital**

13 Although the issue of an appropriate return on equity has not been a "contentious"
14 issue in this rate case, there is still more than \$200,000 of operating income at issue at
15 opposite ends of the parties' respective positions. This is due in large part to the same
16 types of differences of opinion between the experts seen in the last rate case, and many
17 water and wastewater utilities regulated by the Commission.

18 For example, RUCO has again proposed the use of a sample group of gas
19 distribution utilities in its cost of equity analysis.¹⁴² Gas utilities are not comparable to the
20 Company because they have significantly less market risk. RUCO's water utility sample
21 has an average beta of 0.75, while RUCO's gas utility sample has an average beta of
22 0.67.¹⁴³ Therefore, the water utility sample has significantly more systematic (market)

23 ¹⁴⁰ Tr. at 510:7-511:3, 588:24 – 585:13.

24 ¹⁴¹ Excerpts from RUCO's Responsive brief, No. 1 CA-CC 09-0001 and No. 1 CA-CC 09-0002
(Consolidated), are attached hereto at **Brief Exhibit 1**.

25 ¹⁴² Rigsby Dt. at 23-25.

26 ¹⁴³ Rigsby Dt. at Schedule WAR-7, page 1.

1 risk than the gas utility sample, and should not be used to estimate BMSC's cost of equity
2 unless an adjustment is made to account for the difference in risk.¹⁴⁴ The Commission has
3 recognized this problem with using gas companies in prior rate cases where the utility has
4 used gas companies in its cost of equity analysis. For example, in Arizona Water's
5 Eastern Group rate case, the Commission rejected the evidence and adopted Staff's
6 argument that because the water utility sample had a lower average beta than the gas
7 utility sample, the cost of equity for the water utility should be lower.¹⁴⁵ RUCO ignores
8 this precedent, as well as the simple reality that because gas companies are less risky
9 today than BMSC, BMSC should have a higher ROE. But then, RUCO's use of gas
10 companies in this case does result in a lower ROE.¹⁴⁶

11 The same is true of RUCO's use of a geometric mean in the CAPM. It is well
12 established that the arithmetic average most accurately approximates the expected future
13 rate of return and is the theoretically correct method for estimating the cost of capital.¹⁴⁷
14 In fact, Mr. Rigsby himself has testified "the consensus among financial analysts is that
15 the arithmetic mean is the better of the two averages."¹⁴⁸ Given Mr. Rigsby's prior
16 testimony, this shouldn't even be an issue in this case, but then, use of the geometric mean
17 also depresses the cost of equity.¹⁴⁹ The same is true of Mr. Rigsby's use of total treasury
18 returns instead of income returns and his failure to consider current market risk.¹⁵⁰ All of
19 these efforts to reduce the ROE downward contribute to RUCO's CAPM of only 6.15

20 ¹⁴⁴ Decision No. 66849 at 21.

21 ¹⁴⁵ Decision No. 66849 at 21 (March 19, 2004); *see also Arizona-American Water Company*
Decision No. 67093 at 27 (June 30, 2004).

22 ¹⁴⁶ Bourassa COC Rb. at 15:3-9.

23 ¹⁴⁷ *See* Bourassa COC Rb at 16:7-21 *citing* multiple authorities.

24 ¹⁴⁸ Cost of Capital Direct Testimony of William A. Rigsby, Docket No. W-01445A-02-0619, at
26; *see also* Cost of Capital Direct Testimony of William A. Rigsby, Docket No. W-01445A-04-
0650, at 26.

25 ¹⁴⁹ Bourassa COC Rb. at 16:11-12.

26 ¹⁵⁰ Bourassa COC Rb. at 17:1-21:14.

1 percent, compared to the cost of an investment grade bond at 6.5 percent.¹⁵¹ These
2 problems further contribute to RUCO's very low recommended ROE of 8.22 percent.
3 The undisputed evidence is that the Company will have a very difficult time attracting
4 capital if RUCO's ROE is approved.¹⁵²

5 Staff's recommended ROE of 9.4 percent is certainly significantly better than
6 RUCO's, but will still make it hard for BMSC to attract capital to Arizona given the
7 returns being earned on other investments available to the Company's parent.¹⁵³ This is
8 due, in large measure, to the fact that Staff's financial risk adjustment is overstated. For
9 one thing, the Hamada adjustment Staff utilizes requires the use of a beta, but BMSC does
10 not have a beta. This means that Staff had to use the beta from Staff's sample water
11 companies, which clearly have less risk than BMSC.¹⁵⁴ Staff does not account for this
12 difference in its financial risk adjustment.

13 Nor does Staff reconcile its use of book values in the Hamada equation, except to
14 say that Staff believes its methodology is reasonable.¹⁵⁵ The Hamada methodology was
15 developed using market values, which is logical given that the Professor's methodology
16 was developed as an extension of the market-based CAPM.¹⁵⁶ No book data is used in the
17 CAPM.¹⁵⁷ Using market data in Staff's financial risk adjustment, however, lowers the
18 adjustment from 80 to 40 basis points.¹⁵⁸

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21 ¹⁵¹ Bourassa COC Rb. at 21:15-22:3.

22 ¹⁵² Sorensen Rb. at 10:8-11:17.

23 ¹⁵³ Sorensen Rb. at 11:1-17.

24 ¹⁵⁴ Bourassa COC Rb. at 5:16-9:5; Bourassa COC Rj. at 4:3-12.

25 ¹⁵⁵ Tr. at 686:13-17.

26 ¹⁵⁶ Bourassa COC Rj. at 5:13-6:3; Tr. at 685:20-686:12.

¹⁵⁷ Tr. at 686:1-3.

¹⁵⁸ Bourassa COC Rj. at 5:11-6:5.

1 In summary, there is evidence in this case of BMSC's access to capital through its
2 parent, APIF, evidence that the parent has and will continue to invest capital in Arizona if
3 it achieves reasonable returns, and evidence that RUCO and Staff's rates of return will
4 discourage, not attract more capital. While financial models may be used to determine an
5 ROE in these rate cases, such models should not be allowed to mask evidence of what the
6 real investors are doing in the real world. In the real world, BMSC must offer a
7 competitive return if it is going to be able to attract the capital that would be available to it
8 to continue to invest in property dedicated to public sewer utility service. The Company's
9 ROE better fulfills these goals than the recommendations of Staff and RUCO.

10 **V. REMAINING RATE DESIGN ISSUES**

11 **A. Town of Carefree Request for CIE Refunds**

12 The Town intervened for the sole purpose of obtaining relief similar to relief the
13 Town, BMSC and RUCO stipulated to shortly after the last rate case.¹⁵⁹ Specifically, the
14 Town asks that refunds of hook-up fees previously ordered in Decision No. 69164 also be
15 given to the individual homeowners living in the CIE subdivision, not just one single
16 refund to the current customer – the CIE HOA. No evidence explains why the CIE HOA
17 is the sole BMSC customer and no party alleges that BMSC failed to comply with the
18 prior order. Nor did any party oppose the relief requested by the Town. The only
19 question raised was Judge Nodes' request that the parties brief whether it would constitute
20 retroactive ratemaking for BMSC to issue 33 refunds in the amount of \$404.64 to the
21 members of the CIE HOA and to debit 1671 other customers by \$7.51 each.¹⁶⁰

22 The relief sought by the Town would not constitute retroactive ratemaking.
23 Retroactive ratemaking occurs when an agency approves a rate and the rate becomes final,
24 then, upon its own initiative, the agency "makes a retroactive determination of a different

25 ¹⁵⁹ Kincaid Dt. at 4-5 and Exhibit 1.

26 ¹⁶⁰ Sorensen Rb. at 4:3-13; Tr. at 61:7-62:14.

1 rate and requires reparations.” *Mountain States Tel. & Tel. Co. v. Arizona Corp. Comm’n*,
2 124 Ariz. 433, 436, 604 P.2d 1144, 1147 (Ariz. Ct. App. 1979); *Arizona Grocery Co. v.*
3 *Atchison, Topeka & Santa Fe R.R. Co.*, 284 U.S. 370 (1932). Such is not the case here.
4 Should the Commission grant the unopposed relief sought by the Town, neither the rates
5 charged by BMSC in the past, nor the rates to be charged in the future will change.
6 Furthermore, the total refund amount ordered in 2006 will also remain unchanged; the
7 Commission would simply be directing a small redistribution to ensure that all those that
8 actually pay for service get a piece of the total refund. This simply isn’t retroactive
9 ratemaking, a prohibitive doctrine applied to protect ratepayers and utilities from changing
10 the costs of service already given. *Arizona Grocery Co.*, 284 U.S. at 389.

11 Accordingly, BMSC supports the relief sought by the Town, as long as such relief
12 remains revenue and rate base neutral as proposed. Additionally, BMSC would not
13 oppose an order that the individual homeowners in the CIE HOA become BMSC’s
14 customers instead of the CIE HOA.¹⁶¹ This change also should not impact the revenue
15 requirement, or even the rate design in any material manner because BMSC currently bills
16 the CIE HOA for each individual home in the subdivision.

17 **B. Dr. Doelle and Special Commercial Rates**

18 Wastewater flows cannot be efficiently metered, except at high volumes, and
19 BMSC does not have access to data on water usage.¹⁶² As a result, the Company’s current
20 tariff uses an ADEQ engineering bulletin as a proxy to determine the flow levels for
21 different types of commercial establishments. Although it is unclear why the Commission
22 first approved this approach, it has been approved several times.¹⁶³ It should be approved
23

24 ¹⁶¹ Sorensen Rb. at 4:14-18.

25 ¹⁶² Sorensen Rb. at 5-6; Sorensen Rj. at 4-5.

26 ¹⁶³ Tr. at 95:21-24.

1 again in this rate case because no party offers a viable alternative to Engineering Bulletin
2 No. 12 for BMSC's more than 130 commercial customers.

3 On the other hand, the tariff provision for more than a dozen special rate
4 commercial customers should be eliminated. No evidence explains the origin of these
5 special rates for less than 10 percent of the total commercial customers and, in fact, only a
6 few of these businesses even exist today.¹⁶⁴ Today, the special customer rates appear
7 unnecessarily discriminatory and require special administration in the billing process.¹⁶⁵
8 As such, BMSC asks that they be eliminated.

9 Dr. Doelle presents a related, but distinguishable issue. Dr. Doelle asserts that
10 Engineering Bulletin No. 12's estimated flows for a dental office do not reflect modern
11 dental technology.¹⁶⁶ Dr. Doelle makes a persuasive case that the engineering bulletin is
12 not an appropriate proxy for a modern dental office.¹⁶⁷ Therefore, the Company does not
13 oppose a rate that recognizes the reduced water use in such a dental facility, relative to
14 what would be called for in strict adherence to the proxy. Such change in rate design does
15 not impact the revenue requirement, it only marginally impacts where the revenue is
16 recovered. Additionally, the relief Dr. Doelle seeks would not be special to Dr. Doelle's
17 business like the existing "special rates" for commercial customers. The rate would apply
18 to any dental office that can show it uses comparable low-flow technology. This is
19 appropriate because the evidence illustrates that Engineering Bulletin No. 12 simply fails
20 to accommodate substantially changed circumstances.

21
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23 _____
24 ¹⁶⁴ Bourassa Dt. at 16-18.

25 ¹⁶⁵ Sorensen Rb. at 4:3-8.

26 ¹⁶⁶ Doelle Supp. St. at 3; Doelle Sb. At 1; Tr. at 70:23-71:19.

¹⁶⁷ Tr. at 69:19-70:13.

1 **C. Hook-Up Fee Tariff**

2 The Company has proposed a hook-up fee tariff. These tariffs are a common
3 means by which regulated water and sewer utilities raise zero cost capital to be used to
4 offset the cost of off-site plant, including wastewater treatment capacity. Even without
5 the plant closure discussed above, the Company will require additional capacity to serve
6 within its existing CC&N.¹⁶⁸ The proposed HUF is consistent with a “growth pays for
7 growth” philosophy. Staff’s opposition to approval of a HUF is, therefore, quite curious.

8 Staff’s Engineer concluded that the Company does not need a HUF because it
9 already has over 1 million gallons of capacity available under its agreement with
10 Scottsdale.¹⁶⁹ This is wrong. BMSC has already purchased 420,000 gallons of capacity
11 from Scottsdale, and it has the right to purchase an additional 580,000 gallons of capacity
12 before expiration of the contract in 2016.¹⁷⁰ During the hearing, Staff’s engineer
13 nevertheless insisted that the Company already has and therefore does not need to build or
14 buy more treatment capacity.¹⁷¹ There is simply no evidence to explain or support Staff’s
15 apparent misunderstanding of the Company’s current capacity and right to acquire more
16 capacity from the City of Scottsdale. Therefore, Staff has failed to offer a basis for denial
17 of any HUF tariff.

18 Staff does, however, offer an alternative in the event the Commission disagrees
19 with Staff that a HUF should be denied.¹⁷² As explained by Mr. Sorensen in his
20 testimony, BMSC accepts Staff’s alternative HUF amounts, and the Company proposes
21 that the Commission approve a HUF tariff using those amounts and Staff’s form of tariff

22 _____
23 ¹⁶⁸ Tr. at 631:25-632:21.

24 ¹⁶⁹ Hains Dt. at Engineering Report.

25 ¹⁷⁰ Tr. at 116:19-117:13.

26 ¹⁷¹ Tr. at 629:13-20, 630:20 – 31:7.

¹⁷² Hains Sb. at 2 and Exhibit 1.

1 from the pending LPSCO case.¹⁷³ The Company's proposed form of HUF tariff is
2 included in the Company's Final Schedules, and reflects additional language
3 recommended by Ms. Hains to ensure that BMSC does not use HUF funds for plant
4 closure.¹⁷⁴ This form of the HUF tariff should be approved.

5 CONCLUSION

6 Based on the foregoing, BMSC respectfully requests the following relief:

- 7 a. A finding that the fair value of BMSC's property devoted to public service
8 is \$3,682,741;
- 9 b. Approval of an overall rate of return on rate base equal to 12.4 percent;
- 10 c. A determination of a revenue requirement of \$2,533,126, which constitutes
11 an increase over adjusted test year revenues of \$952,956, an increase of 60.31 percent
12 over the test year;
- 13 d. Approval of a plant closure cost surcharge mechanism to go into effect
14 following completion of the plant closure project;
- 15 e. Approval of the Company's final requested form of hook up fee tariff which
16 is attached to the Brief as **Brief Exhibit 2**; and
- 17 f. For such other and further relief as the Commission deems appropriate.

18 RESPECTFULLY SUBMITTED this 14th day of December, 2009.

19 FENNEMORE CRAIG, P.C.

20
21 By _____

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25 _____
¹⁷³ Sorensen Rj. at 11:13-15.

26 ¹⁷⁴ Tr. at 637:9-14.

1 **ORIGINAL** and thirteen (13) copies
2 of the foregoing were filed
3 this 14th day of December, 2009, with:

4 Docket Control
5 Arizona Corporation Commission
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7 Phoenix, AZ 85007

8 **Copy of the foregoing was hand delivered**
9 this 14th day of December, 2009, with:

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By: *Maria San Jose*

**Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609**

**INITIAL CLOSING BRIEF
December 14, 2009**

Brief Exhibit 1

IN THE COURT OF APPEALS

STATE OF ARIZONA

DIVISION ONE

GOLD CANYON SEWER COMPANY,
an Arizona corporation,

Appellant,

v.

**ARIZONA CORPORATION
COMMISSION,**
an agency of the State of Arizona,

Appellee,

**RESIDENTIAL UTILITY CONSUMER
OFFICE,**

Intervenor/Appellee.

No. 1 CA-CC 09-0001
No. 1 CA-CC 09-0002
(Consolidated)

Arizona Corporation Commission
No. SW-02519A-06-0015

Decision Nos. 70624 and 70662

**INTERVENOR/APPELLEE
RESIDENTIAL UTILITY CONSUMER OFFICE'S
RESPONSIVE BRIEF**

Daniel W. Pozefsky (No. 013077)
Michelle L. Wood (No. 012422)
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structures is well settled.⁶⁴ In Litchfield Park Service Co. v. Arizona Corporation Comm'n, this Court concluded that the Commission did not abuse its discretion when it made a downward adjustment to a utility's cost of equity capital to reflect reduced investor risk from its equity-rich plant.⁶⁵ Moreover, this Court held that the Commission did not act contrary to its prior decision in reducing the amount of common equity from 68.6 percent to 51.8 percent.⁶⁶ Likewise, in this matter, the Court should conclude that the Commission did not err in reducing the Company's cost of equity capital to reflect reduced investor risk from its 100% equity rich plant. Moreover, consistent with its ruling in Litchfield Park, the Court should conclude that the Commission did not act contrary to prior decisions in reducing the common equity from 100 percent to 60 percent.

There are many instances in which the Commission has imputed a hypothetical capital structure for the benefit of shareholders.⁶⁷ Utilities which had little or no equity and a disproportionate amount of debt have requested the

⁶⁴ Litchfield Park Service Co. v. Arizona Corp. Comm'n, 178 Ariz. 431, 434, 874 P.2d 988, 991 (App. 1994).

⁶⁵ Id.

⁶⁶ In the prior decision-involving the utility, the Commission approved a capital structure for the sewer division of 30.95 percent debt and 69.05 percent equity. Litchfield Park Service Co., Decision No 56362.

⁶⁷ Decision No. 68487 (Southwest Gas – Docket # G-01551A-04-0876, February 23, 2006), Decision No. 69440 (Arizona American Mohave District – Docket # WS-01303A-06-0014, May 1, 2007), Decision 70011 (UNS Gas – Docket No. G-04204A-06-0463 et. al., November 27, 2007), Decision No. 58497 (Tucson Electric Power Docket No. U-1933-93-006, January 13, 1994), Decision No. 56659 (Tucson Electric Power Docket No. U-1933-88-280, October 24, 1989).

Commission impute a hypothetical capital structure for a more balanced debt equity structure and the Commission has granted the requests.⁶⁸ The result has been a greater return for the shareholders. If it is appropriate for Commission to impute a hypothetical capital structure for the benefit of shareholders, it must be equally appropriate to impute a hypothetical capital structure for the benefit of ratepayers.

Appellant specifically complains that the Commission's decisions conflict with its conclusions in Decision No. 69164 in the matter of Black Mountain Sewer Company ("Black Mountain").⁶⁹ In Decision 69164, the Commission adopted Black Mountain's 100% equity capital structure. Appellant asserts that Black Mountain and Gold Canyon, both owned by Algonquin, located on the outskirts of Phoenix, cannot be distinguished and therefore the Commission should approve the Company's 100% capital structure as it did for its sister company, Black Mountain. Clearly, as this Court held in Litchfield Park Service Co. v. Arizona Corporation Comm'n, the Commission has the discretion to rule differently in similar cases.⁷⁰ Although Black Mountain and Gold Canyon are both 100% equity companies

⁶⁸ Id.

⁶⁹ Appellant's Brief, Appendix, Tab 5, Decision No. 69164

⁷⁰ CR, Tab C, 20, Gold Canyon's Response to RUCO's Second Set of Data Requests. 2.6.

owned by Algonquin, the utilities are distinguishable.⁷¹ Gold Canyon has approximately 5,500 customers and Black Mountain had at the time of its rate case 1,957 customers.⁷² Black Mountain had a Fair Value Rate Base (“FVRB”) and Original Cost Rate Base (“OCRB”) of \$1,568,502 and an adjusted operating income of \$11,595 for its test year.⁷³ Gold Canyon’s FVRB and OCRB was \$15,371,260. It had an adjusted operating income of \$562,633 for its test year, but received a 48.93% increase for \$1,312,706 in operating income. Contrary to the Appellant’s assertions, Gold Canyon and Black Mountain are clearly distinguishable based on size, customer connections, operating income, revenues, expenses and rate base. The Commission considers these factors in determining an appropriate cost of capital. Because the cases of Gold Canyon and Black Mountain are so clearly distinguishable, the Commission did not err in treating them differently.

The Company presumes that the ruling in Black Mountain is the precedent upon which all future decisions of the Commission should be based. It’s clear that

⁷¹ Algonquin Water Resource of America (“Algonquin”) is a wholly owned subsidiary of Algonquin Power Income Fund (“APIF”). APIF owns energy, water and wastewater and related assets of approximately \$800 million in the U.S. and Canada. In Arizona, APIF owns seven water and wastewater companies serving approximately 50,000 customers. APIF also own 10 other water and wastewater utilities in Texas, Illinois, and Missouri. See Appellant’s Brief, Appendix, Tab 5, at 1-2.

⁷² Id. at 1. See also Appellant’s Brief, Appendix, Tab 3, Attachment 1.

⁷³ Id. at 4. See also Tab 3, Attachment 1.

in deciding Gold Canyon, the Commission's view of 100 percent equity capital structures has shifted. The Commission vote reflects some recognition that a 100 percent equity structure is unfair to ratepayers and should not be permitted. In casting her vote, Commissioner Mayes stated:

"I think in our original case, unfortunately, the Commission was over, well, erred on the side of the shareholders. And in this case we have at least rebalanced that equation, and in particular we rebalanced that equation with the introduction of the hypothetical capital structure. And I can tell you from my standpoint that I will be very vigilant from this day forward about the use of 100 percent equity structures by companies. It just is not appropriate. It is no more appropriate than if a company walked in her with 100 percent debt structure".⁷⁴

The Commission's adoption of a hypothetical capital structure is based on a shift in policy and recognition of the imbalance struck by 100 percent equity structures. Accordingly, in light of the Commission's vote and the well-reasoned position of Commissioner Mayes, this Court should not perceive the Black Mountain decision as a precedent from which the Commission cannot depart.

- 4. The Commission decision to reconsider and rescind its prior order regarding the Company's cost of capital and operating expenses is reasonable and lawful.**

The Appellant asserts that the Commission violated A.R.S. §40-253 by hearing issues not included in RUCO's request for rehearing. Specifically, Appellant argues that Commission's reconsideration of cost of equity capital and

⁷⁴ CR, Tab B, 18 at 220

**Black Mountain Sewer Corporation
Docket No. SW-02361A-08-0609**

**INITIAL CLOSING BRIEF
December 14, 2009**

Brief Exhibit 2

TARIFF SCHEDULE

UTILITY: Black Mountain Sewer Corporation
DOCKET NO. SW-02361A-08-0609

DECISION NO. _____
EFFECTIVE DATE: _____

OFF-SITE FACILITIES HOOK-UP FEE (WASTEWATER)

I. Purpose and Availability

The purpose of the off-site facilities hook-up fees payable to **Black Mountain Sewer Corporation** ("the Company") pursuant to this tariff is to equitably apportion the costs of constructing additional off-site facilities to provide wastewater treatment and disposal facilities among all new service laterals. These charges are applicable to all new service laterals undertaken via Collection Main Extension Agreements, or requests for service not requiring a Collection Main Extension Agreement, entered into after the effective date of this tariff. The charges are one-time charges and are payable as a condition to Company's establishment of service, as more particularly provided below.

II. Definitions

Unless the context otherwise requires, the definitions set forth in R-14-2-601 of the Arizona Corporation Commission's ("Commission") rules and regulations governing sewer utilities shall apply interpreting this tariff schedule.

"Applicant" means any party entering into an agreement with Company for the installation of wastewater facilities to serve new service laterals, and may include Developers and/or Builders of new residential subdivisions, and industrial or commercial properties.

"Company" means Black Mountain Sewer Corporation.

"Collection Main Extension Agreement" means an agreement whereby an Applicant, Developer and/or Builder agrees to advance the costs of the installation of wastewater facilities necessary to serve new service laterals, or install wastewater facilities to serve new service laterals and transfer ownership of such wastewater facilities to the Company, which agreement does not require the approval of the Commission pursuant to A.A.C. R-14-2-606, and shall have the same meaning as "Wastewater Facilities Agreement."

"Off-Site Facilities" means the wastewater treatment plant, sludge disposal facilities, effluent disposal facilities and related appurtenances necessary for proper operation, including engineering and design costs. Off-site facilities may also include lift stations, force mains, transportation mains and related appurtenances necessary for proper operation if these facilities are not for the exclusive use of the Applicant and benefit the entire wastewater system.

“Service Lateral” means and includes all service laterals for single-family residential, commercial, industrial or other uses.

III. Wastewater Hook-up Fee

For each new service lateral, the Company shall collect an off-site facilities hook-up fee as listed in the following table:

TREATMENT PLANT HOOK-UP FEE TARIFF TABLE		
Service Lateral Size	Factor	Fee
4-inch	1	\$1,734
6-inch	2.25	\$3,901
8-inch	4	\$6,936
10-inch	6.25	\$10,837

IV. Terms and Conditions

(A) Assessment of One Time Off-Site Facilities Hook-up Fee: The off-site facilities hook-up fee may be assessed only once per parcel, service lateral, or lot within a subdivision (similar to a service lateral installation charge).

(B) Use of Off-Site Facilities Hook-up Fee: Off-site facilities hook-up fees may only be used to pay for capital items of off-site facilities, or for repayment of loans obtained to fund the cost of installation of off-site facilities. Off-site hook-up fees shall not be used to cover repairs, maintenance, the cost of closing wastewater treatment plant, including lift stations, or other operational purposes.

(C) Time of Payment:

- (1) In the event that the person or entity that will be constructing improvements (“Applicant,” “Developer,” or “Builder”) is otherwise required to enter into a Collection Main Extension Agreement, payment of the fees required hereunder shall be made by the Applicant, Developer or Builder when operational acceptance is issued for the on-site wastewater facilities constructed to serve the improvement.
- (2) In the event that the Applicant, Developer or Builder for service is not required to enter into a Collection Main Extension Agreement, the hook-up fee charges hereunder shall be due and payable at the time wastewater service is requested for the property.

(D) Off-Site Facilities Construction by Developer: Company and Applicant, Developer, or Builder may agree to construction of off-site facilities necessary to serve a particular development by Applicant, Developer or Builder, which facilities are then conveyed to Company. In that event, Company shall credit the total cost of such off-site

facilities as an offset to off-site hook-up fees due under this Tariff. If the total cost of the off-site facilities constructed by Applicant, Developer or Builder and conveyed to Company is less than the applicable off-site hook-up fees under this Tariff, Applicant, Developer or Builder shall pay the remaining amount of off-site hook-up fees owed hereunder. If the total cost of the off-site facilities contributed by Applicant, Developer or Builder and conveyed to Company is more than the applicable off-site hook-up fees under this Tariff, Developer or Builder shall be refunded the difference upon acceptance of the off-site facilities by the Company.

(E) Failure to Pay Charges; Delinquent Payments: The Company will not be obligated to make an advance commitment to provide or actually provide wastewater service to any Developer, Builder or other applicant for service in the event that the Developer, Builder or other applicant for service has not paid in full all charges hereunder. Under no circumstances will the Company connect service or otherwise allow service to be established if the entire amount of any payment has not been paid.

(F) Off-Site Hook-Up Fees Non-refundable: The amounts collected by the Company pursuant to the off-site hook-up fee tariff shall be non-refundable contributions in aid of construction.

(G) Use of Off-Site Hook-Up Fees Received: All funds collected by the Company as off-site facilities hook-up fees shall be deposited into a separate account and bear interest and shall be used solely for the purposes of paying for the costs of installation of off-site facilities, including repayment of loans obtained for the installation of off-site facilities.

(H) Off-Site Facilities Hook-Up Fee in Addition to On-site Facilities: The off-site facilities hook-up fee shall be in addition to any costs associated with the construction of on-site facilities under a Collection Main Extension Agreement.

(I) Disposition of Excess Funds: After all necessary and desirable off-site facilities are constructed utilizing funds collected pursuant to the off-site facilities hook-up fees, or if the off-site facilities hook-up fee has been terminated by order of the Arizona Corporation Commission, any funds remaining in the trust account shall be refunded. The manner of the refund shall be determined by the Commission at the time a refund becomes necessary.

(J) Status Reporting Requirements to the Commission: The Company shall submit a calendar year Off-Site Facilities Hook-Up Fee status report each January to Docket Control for the prior twelve (12) month period, beginning January 2011, until the hook-up fee tariff is no longer in effect. This status report shall contain a list of all customers that have paid the hook-up fee tariff, the amount each has paid, the physical location/address of the property in respect of which such fee was paid, the amount of money spent from the account, the amount of interest earned on the funds within the tariff account, and an itemization of all facilities that have been installed using the tariff funds during the 12 month period.