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Arizona Corporation Commission

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

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

DOCKET NO. W-02069A-08-0406

**SUNRISE WATER COMPANY'S  
APPLICATION FOR REHEARING  
OF DECISION NO. 71445**

1 Pursuant to A.R.S. § 40-253, Sunrise Water Company ("Sunrise") hereby applies for  
2 rehearing of Arizona Corporation Commission ("Commission") Decision No. 71445 entered  
3 December 23, 2009 (the "Decision").

4 Sunrise asks the Commission to rehear the Decision for the purpose of amending it to  
5 provide Sunrise an operating margin of 10 percent.

6 **DISCUSSION**

7 The Decision did not allow Sunrise to recover test-year income tax expense. The  
8 Decision was based on the fact that LLCs and Subchapter S corporations are not income tax-  
9 paying entities. However, the Commission did not dispute that income taxes for these entities  
10 must ultimately be paid by the investors, in this case, Mr. Campbell.

11 The Decision also did not dispute that only the funds left over after paying taxes and  
12 other business expenses are available to fund additional plant investment. If income-tax  
13 expenses are not recoverable, the effect is to reduce the allowed return on equity and diminish  
14 the funds available for plant investment. As the Commission is well aware, small water  
15 companies, many of which are LLCs or S-Corps, are struggling to raise the funds they require to  
16 invest in new infrastructure.

1 Many LLCs and Subchapter S corporations have *de minimus* or even negative rate bases  
2 for ratemaking purposes. For these entities with inadequate rate bases, the Commission typically  
3 sets rates so as to provide at least a 10-percent operating margin. At the other extreme, larger  
4 entities, which are almost always Subchapter C-corporations, have rates set using traditional rate-  
5 of-return ratemaking, including recovery of income-tax expense. The Decision places Sunrise in  
6 a gray area between the operating-margin and rate-of-return ratemaking (with income-tax  
7 recovery) methodologies. The result is that Sunrise is being treated worse than it would be under  
8 either of the Commission's traditional ratemaking methodologies.

9 Unlike many other Arizona water-utility investors, Mr. Campbell has provided Sunrise  
10 the funds needed to invest in water infrastructure, including arsenic-remediation facilities. As a  
11 result, Sunrise has a substantial rate base and, although it was under-earning, it was able to  
12 generate verifiable taxable income in the test-year. Yet, the Decision would provide Sunrise an  
13 operating margin of just 7.43 percent, much worse than the minimum 10-percent operating  
14 margin provided for utilities even with negative rate bases and no taxable income in the test  
15 year.<sup>1</sup>

16 If the Commission will not allow Sunrise to recover income tax expense, then Sunrise  
17 asks the Commission to at least treat it no worse than it treats water companies that have not  
18 made sufficient investment in plant to generate a positive rate base. Mr. Campbell has set a good  
19 example by investing the funds needed to build and maintain a modern, safe water utility,  
20 including arsenic-remediation facilities. This is exactly the behavior that the Commission is  
21 trying to encourage from utility investors.

22 Providing Sunrise less than a 10-percent operating margin would send a message to  
23 Arizona utilities and their investors that the Commission will treat utilities making needed  
24 infrastructure investments worse than utilities that have neglected their rate bases. This would be  
25 the wrong message to send.

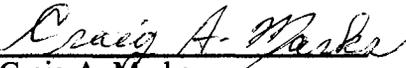
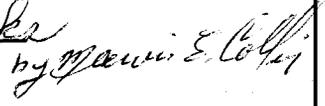
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<sup>1</sup> Operating Margin = Operating Income/Revenue Requirement, or  $\$104,020 \div \$1,399,237 = 7.43\%$ . See Decision at 40:20-23.

1 **REQUESTED RELIEF**

2 Sunrise asks the Commission to rehear the Decision and amend it so as to provide  
3 Sunrise a 10-percent operating margin. Exhibit A is a proposed amendment to that effect.

4 RESPECTFULLY SUBMITTED on January 6, 2010.  
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By:

  
Marvin Collins

**REQUESTED OPERATING MARGIN AMENDMENT  
TO DECISION NO. 71445**

Page 37, Line 16,

INSERT new paragraph after paragraph 88:

89. Although we have determined that allowing income-tax expense for Sunrise would be inconsistent with the Commission's long-standing policy of denying recovery of income tax expense for pass-through entities, we do note that, in contrast to many other Arizona water utilities, Sunrise has made sufficient investment in plant to generate a substantial positive rate base. Mr. Campbell has provided Sunrise the funds needed to invest in water infrastructure, including arsenic-remediation facilities. As a result, Sunrise has an adequate rate base. Yet, by denying income-tax recovery the Commission would provide Sunrise an operating margin of just 7.43 percent, substantially less than the 10-percent operating margin the Commission traditionally provides for utilities with negative or minimal rate bases. Certainly, Sunrise should be treated no worse than these financially-distressed utilities, so we will depart from traditional rate-of-return ratemaking and calculate Sunrise's revenue requirement so as to provide it a 10-percent operating margin.

RENUMBER subsequent paragraphs.

Page 40, line 13,

DELETE existing paragraph 99 and replace with:

Under the circumstances discussed in this Decision it is appropriate to depart from traditional rate-of-return ratemaking and instead calculate Sunrise's revenue requirement so as to provide it a 10-percent operating margin.

**REQUESTED OPERATING MARGIN AMENDMENT  
TO DECISION NO. 71445**

Page 40, line 20,

DELETE first sentence of existing paragraph 101 and REPLACE with the following sentence:

Based on the adjustments made herein, we find that Sunrise should be permitted to recover operating income of \$143,913 and total operating expenses of \$1,295,217, for an overall revenue requirement of \$1,439,130.

Page 40, line 27,

DELETE the last two sentences of paragraph 102 and REPLACE with the following two sentences:

With the rates adopted herein, the monthly bill for a customer served by a 3/4" meter with average consumption will increase from \$62.68 to \$63.23, representing an increase of \$0.55 or 0.88% percent. Furthermore, the monthly bill for a customer served by a 3/4" meter with median consumption will decrease from \$50.41 to \$49.24, representing a decrease of \$1.17 or 2.32 percent.

Page 43, Lines 13 through 25,

In each place in which the figures appear:

REPLACE "\$1.75" with "\$1.80"

REPLACE "\$2.50" with "\$2.61"

REPLACE "\$3.15" with "\$3.25"

Make all other conforming changes