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ARIZONA CORPORATION COMMISSION  
DOCKET CONTROL

**BEFORE THE ARIZONA CORPORATION COMMISSION**

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

DOCKET NO: SW-01428A-09-0103

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

DOCKET NO: W-01427A-09-0104

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

DOCKET NO. W-01427A-09-0116

Arizona Corporation Commission

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

DOCKET NO. W-01427A-09-0120

**LITCHFIELD PARK SERVICE COMPANY**  
**REPLY CLOSING BRIEF**

**February 24, 2010**

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## TABLE OF ABBREVIATIONS AND CONVENTIONS

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

### LITCHFIELD PARK SERVICE COMPANY PRE-FILED TESTIMONY

9 Pre-Filed Testimony	Hearing Exhibit	Abbreviation
10 Direct Testimony of Greg Sorensen	A-1	Sorensen Dt.
11 Amended Rebuttal Testimony of Greg Sorensen	A-2	Sorensen Amended Rb.
12 Rejoinder Testimony of Greg 13 Sorensen	A-3	Sorensen Rj.
14 Rebuttal Testimony of Brian McBride	A-4	McBride Rb.
15 Rejoinder Testimony of Brian McBride	A-5	McBride Rj.
16 Rejoinder Testimony of Gerald 17 Tremblay	A-9	Tremblay Rj.
18 Direct Testimony of Tom Bourassa (Rate Base)	A-14	Bourassa Dt.
19 Direct Testimony of Tom Bourassa 20 (Cost of Capital)	A-15	Bourassa COC Dt.
21 Amended Rebuttal Testimony of Tom Bourassa (Rate Base)	A-16	Bourassa Amended Rb.
22 Rebuttal Testimony of Tom Bourassa 23 (Cost of Capital)	A-17	Bourassa COC Rb.
24 Rejoinder Testimony of Tom Bourassa (Rate Base)	A-18	Bourassa Rj.

25  
26 \* LPSCO filed its Final Schedules on February 1, 2010.

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

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

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

**STAFF  
PRE-FILED TESTIMONY**

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

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

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

	<b>Pre-Filed Testimony</b>	<b>Hearing Exhibit</b>	<b>Abbreviation</b>
15			
16	Direct Testimony of Richard Darnall	LP-2	Darnall Dt.
17	Surrebuttal Testimony of Richard Darnall	LP-3	Darnall Sb.
18			

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**OTHER PORTIONS OF THE RECORD**

<b>Document</b>	<b>Hearing Exhibit</b>	<b>Abbreviation</b>
Hearing Transcript January 5-8, 11, 14 and 15, 2010	--	Tr.
Hearing Transcript Public Comment on January 4, 2010	--	Tr. (PC)
Analysis of Shared Services Model in Comparison to Stand Alone	<b>A-10</b>	
(Amended) Corporate Cost Allocation Comparative Cost Per Customer Analysis	<b>A-11</b>	
Allocation Methodology Analysis	<b>A-12</b>	
Decision No. 71447	<b>A-13</b>	
List of Stipulated Facts (as amended)	<b>A-23</b>	
Response to RUCO MJR 3.7	<b>A-25</b>	
Deposition Transcript of M. Rowell	<b>A-28</b>	
Oct. 18, 2007 Staff as to operational inquiry to PVWRF	<b>A-35</b>	
Company Response to RUCO Data Request MJR 5.4	<b>A-36</b>	
Estimate of Retirement Costs	<b>A-39</b>	
Phase-In Calculation (Draft)	<b>A-40</b>	
Draft 2006 Evaluation Report	<b>R-2</b>	
ADEQ APP other amendment	<b>R-5</b>	
NARUC Waste Water System of Accounts Capital/Expense	<b>R-20</b>	
NARUC System of Accounts Water Capital/Expense	<b>R-21</b>	
Comparison of Water Rates	<b>LP-4</b>	
2288537.5		



1 case to address concerns over the magnitude of the rate increases necessary to provide  
2 LPSCO just and reasonable rates as defined in *Scates*.<sup>5</sup>

### 3 ARGUMENT

#### 4 I. REPLY ON RATE BASE ISSUES

5 A number of rate base issues remain in dispute between LPSCO and Staff and  
6 RUCO. Notably, however, Staff supports the Company on the rate base issues in dispute  
7 with RUCO and RUCO supports the Company on the issues in dispute with Staff. The  
8 singular rate base issue in dispute with the City is the City's attempt to use the Company's  
9 \$25 million used and useful PVWRF as a basis to deprive LPSCO of a fair and reasonable  
10 rate of return. The City's arguments are addressed, in part, in connection with RUCO's  
11 unsupported \$3.5 million plant adjustment.

#### 12 A. RUCO's Disallowance For The PVWRF Upgrades Should Be Denied.

13 As stated in LPSCO's opening brief, the most significant disputed issue relating to  
14 rate base is RUCO's proposed disallowance of plant upgrade costs at PVWRF. RUCO  
15 continues to propose a \$3,500,000 disallowance in its closing brief.<sup>6</sup> In no uncertain  
16 terms, the evidentiary record is clear that those Upgrades were necessary because of  
17 changed conditions surrounding the plant, which caused operational challenges at the  
18 plant.<sup>7</sup> The record also is undisputed that those Upgrades resulted in better and more cost  
19 effective utility service.<sup>8</sup>

20 <sup>5</sup> *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 534, 578 P.2d 612, 615 (App. 1978) ("the rates  
21 established by the Commission should meet the overall operating costs of the utility and produce a  
22 reasonable rate of return. It is equally clear that the rates cannot be considered just and reasonable if they  
fail to produce a reasonable rate of return or if they produce revenue which exceeds a reasonable rate of  
return").

23 <sup>6</sup> RUCO Br. at 4.

24 <sup>7</sup> Sorensen Amended Rb. at 20 – 24; McBride Rb. at 4 – 6; McBride Rj. at 2 – 3; Sorensen Rj. at 2 – 4; Tr.  
at 30 – 32, 119 – 120, 122 – 123, 137 – 141, 154 – 165, 183 – 190, 215 – 220, 225 – 230, 232 – 233, 1278  
– 1287, 1308, 1325 – 1329, 1338 – 1340, 1357.

25 <sup>8</sup> *Id.*; see also Staff Br. at 13 ("Staff believes that the upgrades did exactly as the Company has suggested –  
26 improved system reliability.").

1 In its closing brief, RUCO does not contest any portion of the underlying record on  
2 those issues. RUCO also doesn't dispute that the PVWRF Upgrades were necessary and  
3 prudent, and have been and will continue to be used and useful in the provision of utility  
4 service to LPSCO's customers. Instead, RUCO continues to assert its argument that those  
5 Upgrades were caused by design errors at PVWRF as originally constructed.<sup>9</sup> This  
6 closing argument is premised entirely on Mr. Rowell's supposition from his pre-filed  
7 direct testimony that the PVWRF upgrades were caused by design errors in the original  
8 plant. That supposition has been proven totally false. *There isn't a shred of evidence*  
9 *supporting RUCO's alleged design errors at PVWRF.* Not only that, but RUCO fails to  
10 recognize that the disallowance is actually contradicted by the undisputed engineering and  
11 operations evidence in the record. The sad truth is that this disallowance is nothing more  
12 than an attempt to confiscate \$3.5 million of used and useful plant.

13 1. RUCO's Argument That PVWRF Had Design Errors In 2002 Is  
14 Without Merit And Contrary To The Evidentiary Record.

15 In its closing brief, RUCO dedicates a total of three pages to its \$3,500,000  
16 disallowance. That RUCO only addresses this issue in three pages of its brief is testament  
17 to the fact that the disallowance is unsupported and unjustified.<sup>10</sup> RUCO's first closing  
18 argument is that the Commission should deduct \$3,500,000 from LPSCO's rate base  
19 because the Upgrades were caused by design errors at PVWRF as originally constructed.<sup>11</sup>  
20 That argument is contrary to the evidentiary record, including undisputed expert  
21

22 <sup>9</sup> RUCO Br. at 3 – 5.

23 <sup>10</sup> It's also testament to the difficulty LPSCO has faced in this rate case. Because RUCO has been allowed  
24 to continue to advance a position unsupported by any competent evidence, let alone the requisite  
25 substantial evidence, the Company has been forced to mount a defense of \$3.5 million of used and useful  
26 rate base. As a result, rate case expense has exceeded all prior estimates. See Section II(D) at 48-50,  
*infra*. No one, besides RUCO, can seriously dispute that RUCO's position on rate base in this case has  
exacerbated LPSCO's rate case expense.

<sup>11</sup> RUCO Br. at 3 – 4.

1 testimony. The engineering testimony provided by Brian McBride, Ray Jones and Staff  
2 witness Marlin Scott was competent and undisputed, and established that the Upgrades  
3 were necessary for added redundancy and reliability measures at the plant.<sup>12</sup> The need  
4 arose because of various changed conditions, *not* because of design errors.<sup>13</sup>

5 To say the least, RUCO's reliance on the direct testimony of Mr. Rowell relating to  
6 these alleged design errors is improper and, frankly, an affront to the concept of  
7 evidentiary standards in any type of litigated proceeding. Not only is Mr. Rowell  
8 *exceptionally unqualified* to render such opinions, but both Mr. Rowell and RUCO's  
9 counsel conceded that Rowell's direct testimony is based solely on a layman's reading of  
10 the testimony of Mr. Sorensen and the McBride draft report.<sup>14</sup> In their pre-filed rebuttal  
11 and rejoinder testimonies, as well as their live testimony at trial, Mr. Sorensen and  
12 Mr. McBride *both expressly testified that the PVWRF did not have any design errors as*  
13 *originally constructed, and that the Upgrades were caused by changed conditions at the*  
14 *plant.*<sup>15</sup> *RUCO does not cite any contrary evidence—primarily because no such*  
15 *evidence exists.*

16 Even so, RUCO continues to argue that "it is unfair that LPSCO customers should  
17 bear the full cost of the upgrades necessitated by the PVWRF's design problems."<sup>16</sup>

18  
19  
20 <sup>12</sup> McBride Rb. at 4 – 6; McBride Rj. at 2 – 3; Tr. at 30 – 32, 119 – 120, 122 – 123, 137 – 141, 154 – 165,  
183 – 190, 215 – 220, 225 – 230, 232 – 233, 1278 – 1287, 1308, 1325 – 1329, 1338 – 1340, 1357;  
Scott Dt. at 1 – 3.

21 <sup>13</sup> *Id.*; see also Sorensen Amended Rb. at 20 – 24; Sorensen Rj. at 2 – 4.

22 <sup>14</sup> Ex. A-28 at 14-15. See also *id.* at 30 ("Ms. Wood:...What we've said is based on Mr. Sorensen's  
23 testimony and the opinions of your engineers....So [Mr. Rowell is] not professing to have an independent  
opinion. He's already told you that he relied on the opinion of Mr. Sorensen and McBride Engineering.").

24 <sup>15</sup> Sorensen Amended Rb. at 20 – 24; McBride Rb. at 4 – 6; McBride Rj. at 2 – 3; Sorensen Rj. at 2 – 4;  
25 Tr. at 30 – 32, 119 – 120, 122 – 123, 137 – 141, 154 – 165, 183 – 190, 215 – 220, 225 – 230, 232 – 233,  
1278 – 1287, 1308, 1325 – 1329, 1338 – 1340, 1357. At deposition, Mr. Rowell also agreed that he would  
consider and defer to rebuttal testimony provided by Mr. Sorensen. Ex. A-28 at 19-20, 34-35.

26 <sup>16</sup> RUCO Br. at 3 – 4.

1 RUCO does not mention, let alone refute, the testimony of Mr. McBride, Mr. Jones, and  
2 Mr. Scott, which reflects that RUCO simply can't refute their testimony on the Upgrades.

3 The stark reality is that RUCO's claim that there were design errors at PVWRF as  
4 originally built is similar to RUCO's claim that the Upgrades added excess capacity to the  
5 plant—both are alluring ways for RUCO to reduce LPSCO's rate base, but both  
6 arguments are imaginary in this case and have been concocted by RUCO in a transparent  
7 effort to lower LPSCO's rates. For example, on page 3 of its brief, RUCO misstates and  
8 mischaracterizes the direct testimony of Greg Sorensen.<sup>17</sup> Mr. Sorensen did not testify or  
9 state that the Upgrades were caused by design errors at the plant. Rather, Mr. Sorensen  
10 testified that PVWRF as originally designed and constructed met all applicable design  
11 standards, and that the Upgrades were necessary to improve plant redundancy and  
12 reliability as a result of changed conditions at the plant.<sup>18</sup>

13 RUCO simply has chosen to ignore Mr. Sorensen's testimony on these issues:

14 Once again, Mr. Rowell has ignored the clear language and  
15 meaning of the rebuttal testimony provided by Brian McBride  
16 and myself. ***The operational challenges presented at  
17 PVWRF were not the result of design errors or construction  
18 errors at the plant as originally constructed. Nor were the  
2007/2008 upgrades caused by design or construction  
errors. Instead, as I stated in my rebuttal testimony, those***

19 <sup>17</sup> *Id.* at 3. It also should be noted that the block quote contained on page 3 of RUCO's closing brief is not  
20 all from Mr. Sorensen's direct testimony. RUCO cites Mr. Sorensen's direct testimony as the source of  
21 that block quote, but only the first sentence from that quote comes from Mr. Sorensen's direct testimony.  
22 The remaining sentences from that block quote are legal arguments asserted by RUCO, which are not  
23 presented in Mr. Sorensen's direct testimony. *See* Sorensen Dt. at 7.

24 <sup>18</sup> Sorensen Amended Rb. at 14 ("The upgrades to the PVWRF were made to optimize our ability to treat  
25 wastewater and to improve the lives and properties of the customers living near the plant by reducing  
26 odors coming from an active wastewater plant."); *Id.* at 15 ("Put simply, the Commission and Staff fully  
supported the Company's upgrades to the PVWRF to optimize reliability, redundancy and service. "); *Id.*  
at 16 ("What we do know is that, between the time the utility was purchased by Algonquin from the prior  
owner/developer and the time of the odor issue and spills (June 2007), the load on the system greatly  
increased due to growth, and residential and commercial development crept much closer to the plant,  
within 165 feet in fact. These changing circumstances changed the operational paradigm for the  
Company, and with the urging of the Commission, we undertook the upgrades that Mr. Rowell now  
proposes to exclude.").

1                    **2007/2008 upgrades increased the plant's reliability and**  
2                    **redundancy capabilities in response to operational**  
3                    **challenges at the plant.** The 2007/2008 upgrades resolved  
4                    various operational challenges with the plant that had arisen  
5                    after operations began in 2002. **Since 2002, the plant faced**  
6                    **operational challenges relating to spills, increased flows and**  
7                    **increasing maintenance costs. We encountered various**  
8                    **operational issues that came to light after operation of the**  
9                    **PVWRF for several years.**<sup>19</sup>

7 RUCO's attempt to mischaracterize the Upgrades as caused or necessitated by design  
8 errors at the plant in 2001-2002 should be rejected.

9                    **The only evidence presented on this issue established that the original plant did**  
10                    **not have any design errors.** Mr. Sorensen testified that “[t]o my knowledge there were  
11 no design flaws or errors for the Palm Valley Water Reclamation Facility. It was  
12 designed according to the rules and regulations of the county, of the city at the time it was  
13 constructed in 2002.”<sup>20</sup> Mr. McBride echoed that sentiment by testifying that the original  
14 plant was reviewed, inspected and approved by ADEQ, Maricopa County and the City of  
15 Goodyear.<sup>21</sup> Ray Jones testified that “the appropriate regulatory agencies, Department of  
16 Environmental Quality and the Maricopa County Environmental Services Department,  
17 reviewed [the plant's] design reports, plans, specifications, issued the appropriate permits,  
18 inspected the facilities when they were complete and issued the permits properly for the  
19 facility.”<sup>22</sup> Staff engineer Marlin Scott determined that the PVWRF Upgrades are used  
20 and useful.<sup>23</sup> Even Mr. Rowell acknowledged that the original plant was reviewed and  
21

22 \_\_\_\_\_  
23 <sup>19</sup> Sorensen Rj. at 4 (emphasis added).

24 <sup>20</sup> Tr. at 31.

25 <sup>21</sup> *Id.* at 227 – 228.

26 <sup>22</sup> *Id.* at 1283.

<sup>23</sup> Scott Dt. at 1 – 3. *See also* Ex. A-35 at 3; Staff Br. at 13 – 14 (“The PVWRF is currently used and useful in service to LPSCo customers...”).

1 approved by ADEQ, Maricopa County and the City of Goodyear, including review and  
2 approval of the engineering, design and construction.<sup>24</sup>

3 RUCO simply can't overcome the undisputed facts. LPSCO operated the PVWRF  
4 successfully until certain operational challenges arose in 2006-2007.<sup>25</sup> LPSCO  
5 experienced rapid growth from 2003-2007, and the flow capacity at PVWRF increased  
6 dramatically in the four years after construction of the plant.<sup>26</sup> As flows to the plant  
7 approached design capacity, the plant experienced various operational challenges and  
8 increased costs. LPSCO then retained McBride Engineering Solutions to evaluate  
9 operational challenges at PVWRF, and to engineer upgrades and improvements.<sup>27</sup>

10 Amazingly, however, that doesn't stop RUCO. In yet another twisting of the  
11 evidentiary record, RUCO claims that "there was obviously something wrong with the  
12 plant if the Company needs to spend \$7.0 million dollars to repair the facility after  
13 spending \$14.9 millions dollars to expand it."<sup>28</sup> That claim is meritless for several equally  
14 persuasive reasons. To start, as noted above, the original plant was designed properly,  
15 met all regulatory standards and was operated successfully until changed conditions led to  
16 operational issues in 2006-2007.<sup>29</sup> RUCO again misstates the underlying facts. The  
17 PVWRF was not expanded in 2002-2003 as RUCO claims.<sup>30</sup> Rather, the PVWRF was  
18

19 \_\_\_\_\_  
<sup>24</sup> Tr. at 860 – 861.

20 <sup>25</sup> *Id.* at 213 – 216; McBride Rb. at 3 – 4; Ex. R-2 at 4 ("While none of the challenges presented below  
21 appear to be preventing the successful operation of the facility, they do show target areas where  
22 improvements could be made to enhance the overall operation, reliability, and cost effectiveness of the  
23 plant.").

24 <sup>26</sup> Sorensen Amended Rb. at 20 – 24; McBride Rb. at 4 – 6; McBride Rj. at 2 – 3; Sorensen Rj. at 2 – 4;  
25 Tr. at 221 – 225, 1354 – 1355; Staff Br. at 10 – 12.

26 <sup>27</sup> Sorensen Amended Rb. at 21 – 22; McBride Rb. at 4.

<sup>28</sup> RUCO Br. at 4.

<sup>29</sup> *See* footnotes 13, 19-21 above.

<sup>30</sup> RUCO Br. at 4.

1 originally designed and constructed in 2002-2003.<sup>31</sup> Further, the original cost of the plant  
2 was \$18,000,000, not \$14,900,000 as RUCO claims.<sup>32</sup>

3 RUCO's claim that there must have been something wrong with the original plant  
4 is nothing more than hyperbola, speculation and innuendo. RUCO simply can't overcome  
5 the litany of *undisputed facts* relating to the Upgrades:

- 6 • As originally designed and constructed, the plant met all applicable  
7 Maricopa County Environmental Services Department, ADEQ and  
8 other regulatory standards, regulations and approval. The plant  
9 engineering and construction was reviewed, analyzed and approved  
10 by Maricopa County, the City of Goodyear and ADEQ.<sup>33</sup>
- 11 • LPSCO operated the PVWRF successfully until certain operational  
12 challenges arose in 2006-2007.<sup>34</sup> LPSCO experienced rapid growth  
13 from 2003-2007, and the flow capacity at PVWRF increased  
14 dramatically during those years.<sup>35</sup> As flows to the plant increased  
15 and began approaching the design capacity in 2006-2007, the plant  
16 experienced various operational challenges.<sup>36</sup>
- 17 • The 2007/2008 Upgrades were improvements to the plant's reliability  
18 and redundancy capabilities and additions to the plant to optimize  
19 performance, not repairs or remedies for any design problems.<sup>37</sup>
- 20 • It is typical in the utility industry for a wastewater treatment plant to  
21 be constructed in accordance with approved engineering plans, but

22 <sup>31</sup> Sorensen Dt. at 6 (“The PVWRF was originally constructed in 2002 and 2003. It was financed initially  
23 with \$7.5 million of 6.7 percent debt, with the remainder of the approximate \$18 million cost financed  
24 with equity. The construction was completed just prior to the purchase of LPSCO by Algonquin.”).

25 <sup>32</sup> *Id.*

26 <sup>33</sup> Sorensen Amended Rb. at 21; McBride Rb. at 3 – 4; McBride Rj. at 1 – 2; Tr. at 227 – 228.

<sup>34</sup> Tr. at 213 – 216; McBride Rb. at 3 – 4; Ex. R-2 at 4.

<sup>35</sup> Sorensen Amended Rb. at 20 – 24; McBride Rb. at 4 – 6; McBride Rj. at 2 – 3; Sorensen Rj. at 2 – 4;  
Tr. at 221 – 225, 1354 – 1355.

<sup>36</sup> *Id.*

<sup>37</sup> Sorensen Amended Rb. at 20 – 24; McBride Rb. at 4 – 6; McBride Rj. at 2 – 3; Sorensen Rj. at 2 – 4;  
Tr. at 30 – 32, 119 – 120, 122 – 123, 137 – 141, 154 – 165, 183 – 190, 215 – 220, 225 – 230, 232 – 233,  
1278 – 1287, 1308, 1325 – 1329, 1338 – 1340, 1357.

1 then face operational challenges as the plant is operated at or near full  
2 capacity over several years.<sup>38</sup>

- 3 • Those operational challenges did not arise until 2006-2007 and  
4 revolved around “certain issues that come up that were not apparent  
5 in the original, when the plant was operating under lower flows,  
6 which will reduce the cost of operating and maintaining the plant.”<sup>39</sup>
- 7 • For PVWRF, those operational challenges and changed conditions  
8 included “a difference in the peaking factors than were anticipated,  
9 differences in the fats, oils and grease content, differences in the  
10 loading rates” and “any number of unpredictable variables.”<sup>40</sup>
- 11 • PVWRF had “a higher level of fats, oils and grease in [the] influent  
12 than is typical.”<sup>41</sup>
- 13 • The odor control requirements for the plant changed as a result of  
14 different zoning requirements around the plant, including a change  
15 from a golf course surrounding the plant to in-fill residential  
16 development 150 feet from the plant’s fence line.<sup>42</sup>
- 17 • It is undisputed that the Upgrades are used and useful.<sup>43</sup> ***Mr. Rowell***  
18 ***expressly testified that the Upgrades are used and useful.***<sup>44</sup>

19 Given all this undisputed evidence in the record, it is hard not to conclude that RUCO is  
20 asserting arguments it knows to be false.<sup>45</sup> These attempts to mislead the Commission  
21 with respect to the clear evidentiary record in this case must be rejected.<sup>46</sup>

22 <sup>38</sup> McBride Rb. at 5 – 6; Tr. at 195 – 197, 1283 – 1286.

23 <sup>39</sup> Tr. at 139.

24 <sup>40</sup> *Id.* at 139 – 140.

25 <sup>41</sup> *Id.* at 155 – 156.

26 <sup>42</sup> *Id.* at 165 – 166.

<sup>43</sup> Staff. Br. at 13 – 14.

<sup>44</sup> Ex. A-28 at 27 (“Q. And you also agree that the 2008 upgrades that were installed by LPSCO are used and useful; correct? A. As far as we can tell, yes.”).

<sup>45</sup> If this matter were being litigated in Superior Court, RUCO’s closing arguments on this issue would be stricken from the record and would raise potential Rule 11 sanctions for flagrantly misrepresenting the evidence presented at trial, misstating the testimony of witnesses and misleading the court or jury. RUCO even misstates the amount of the disallowance. In its closing brief, RUCO “requests exclusion of \$3.5 million dollars of the capital improvements to the PVWRF.” RUCO Br. at 5. In its final schedules, however, RUCO proposes a reduction of \$3,286,229 from LPSCO’s wastewater rate base to remove costs associated with the PVWRF at 50 percent of amount incurred (\$3,500,000) minus retirements provided by



1 Mr. McBride testified that the operational challenges resulted from conditions that were  
2 not present when the plant was designed and constructed.<sup>52</sup>

3 RUCO's suggestion that the plant should have been designed for unknown  
4 reliability contingencies is contrary to industry standards for designing sewer plants.  
5 Here, it is clear that PVWRF "worked as designed."<sup>53</sup> The Upgrades resulted from  
6 changed conditions and operational challenges that arose 4-5 years after original  
7 construction. RUCO doesn't have any basis for arguing that LPSCO should have known  
8 about reliability issues and operational challenges when Liberty Water acquired LPSCO  
9 in 2003. The need for the Upgrades did not arise until 2006-2007, at which point LPSCO  
10 invested capital and installed the Upgrades, which are now used and useful and belong in  
11 rate base without deduction.

### 12 3. RUCO's Policy Argument Should Be Ignored.

13 Finally, RUCO hypothesizes that utilities will not build plants properly in the first  
14 place if they know that the subsequent costs of fixing the plant will be passed on to  
15 ratepayers.<sup>54</sup> RUCO also suggests that a company looking to purchase an Arizona utility  
16 "will have less incentive to do proper due diligence if they knew that the costs of fixing  
17 any existing problems could be imposed on ratepayers."<sup>55</sup> Frankly, these "policy"  
18 arguments are laughable and merit little attention.

19 RUCO's suggestion that a utility owner will not conduct a due diligence before  
20 spending millions of dollars on an Arizona utility is absurd. Even Mr. Rowell agreed that  
21 buyers are required by lenders to conduct a proper due diligence before acquiring a  
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23 <sup>52</sup> *Id.* at 139 – 140.

24 <sup>53</sup> *Id.* at 215.

25 <sup>54</sup> RUCO Br. at 5.

26 <sup>55</sup> *Id.*

1 water/sewer utility.<sup>56</sup> Further, utilities obviously are required to comply with applicable  
2 regulatory, design and engineering standards when building a plant, irrespective of  
3 whether the plant costs are included in rate base.

4 RUCO again cites page 6 of Mr. Rowell's testimony in support of these alleged  
5 "policy" arguments. At his deposition, however, Mr. Rowell acknowledged that adoption  
6 of RUCO's disallowance would inhibit investments in Arizona utilities and the lack of  
7 cost certainty will make it less likely for buyers to acquire small Arizona water and sewer  
8 companies.<sup>57</sup> Mr. Rowell also agreed that it is good policy to encourage buyers to acquire  
9 small water and sewer utilities in Arizona.<sup>58</sup>

10 As a matter of public policy, RUCO's disallowance, if adopted, would send a  
11 precarious message to the utility industry. It would tell existing owners of utilities that  
12 any investment made post-acquisition or after original construction to fix the utility or  
13 upgrade facilities may be confiscated by the Commission. It would tell potential buyers  
14 of utilities not to acquire a utility with existing facility or service problems. Buyers  
15 simply won't acquire Arizona utilities if necessary upgrades to those utilities will be  
16 deducted from rate base. That's not to mention that existing customers would suffer  
17 because operational problems would never get addressed or resolved, and struggling  
18 utilities (such as the McLain utilities) would not get acquired by new owners with the  
19 ability to upgrade service. The bottom line is that adoption of RUCO's proposed  
20 disallowance would strongly discourage investment in Arizona utilities. One might even  
21 call RUCO's policy arguments frightening because adopting RUCO's "policy" would

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22 <sup>56</sup> Ex. A-28 at 84 – 85. Mr. Rowell went on to testify that he is not aware of any company "buying a  
23 utility in Arizona [that] didn't conduct a proper due diligence because they thought that the cost of fixing  
24 any existing problems could be imposed on ratepayers." *Id.* at 85. It also should be noted that Mr. Rowell  
has never been involved in an acquisition of a sewer or water utility, and he does not know what type of  
due diligence is standard in the industry for such acquisitions. *Id.* at 84.

25 <sup>57</sup> *Id.* at 47, 100 – 102.

26 <sup>58</sup> *Id.* at 101 – 102.

1 discourage investment, encourage utilities not to fix pre-existing problems, and prevent  
2 the sale of any utility with any current or potential operational challenges. Further,  
3 RUCO's policy would compel utility owners to over-build plant to address every potential  
4 "worst case operating scenario imaginable," which will burden customers with  
5 unnecessary plant costs.

6 On a final note, it bears emphasis that, in its closing brief, RUCO does not claim  
7 that LPSCO's customers have suffered any *actual harm* from the 2007-2008 Upgrades.  
8 RUCO says only that it is unfair for ratepayers to pay for design errors at the plant.  
9 Obviously, such unfairness is non-existent if there were no design errors in the first place.  
10 Also, as stated by Staff, the PVWRF and Upgrades are "currently used and useful in  
11 service to LPSCO customers . . ."<sup>59</sup> The notion that it is unfair to ratepayers to include  
12 used and useful plant in rate base is contrary to Arizona's constitutional rate setting  
13 framework, which entitles LPSCO to earn a return on used and useful plant.<sup>60</sup>

14 4. Staff Supports Inclusion Of The Upgrades In LPSCO's Rate Base.

15 On this issue, Staff fully supports inclusion of the full amount of the \$7,000,000 in  
16 Upgrades in LPSCO's rate base.<sup>61</sup> The statements from Staff's closing brief further  
17 document the undisputed and controlling evidence relating to changed conditions,  
18 operational challenges and necessary upgrades at PVWRF:

- 19 • "The Company's most recent previous rate case was filed using a  
20 2000 test year. At that time, the Company had approximately 5,541  
21 water customers and 5,012 wastewater customers. At the end of the  
22 test year in this matter, the Company had over 15,000 water  
23 customers and 14,000 wastewater customers."<sup>62</sup>
- 24 • "At the time of construction, the land surrounding the plant contained  
25 only a golf course, with some commercial office space planned as  
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<sup>59</sup> Staff Br. at 13 – 14.

<sup>60</sup> See LPSCO Br. at 6 – 9.

<sup>61</sup> Staff Br. at 10 – 14.

<sup>62</sup> *Id.* at 10.

1 well. As a result, the Company received setback variances from both  
2 the City of Goodyear...and the Arizona Department of  
3 Environmental Quality...for an odor setback of only 150 feet, rather  
4 than the now customary 350-foot minimum.”<sup>63</sup>

- 5 • “Shortly thereafter, Goodyear re-zoned the area surrounding  
6 PVWRF. The result was the approximate tripling of the Company’s  
7 customer base over the next five years. The new growth encroached  
8 on the territory surrounding the PVWRF and as a result of its  
9 proximity, the Company began to receive odor complaints in 2006  
10 and 2007. In addition, the Company experienced two separate spill  
11 incidents in the summary of 2007.”<sup>64</sup>

12 Staff completely refuted RUCO’s argument “that the significant dollar value of the  
13 upgrades in comparison to the original cost of the facility is proof that the facilities were  
14 poorly designed.”<sup>65</sup> In its brief, Staff correctly stated that “the logic of such argument,  
15 however, is lacking. If the plant was designed to meet the best-estimated demand, but  
16 real-world, actual operational factors required the Company to build in redundancies that  
17 would increase operational reliability, as opposed to capacity, then the dollar value of the  
18 repairs would be irrelevant, as would be the number of total projects needed to increase  
19 reliability. Obviously, the Company would have no way to know at the time the facility  
20 was constructed which of the design assumptions would turn out to be inaccurate, and  
21 certainly would have no way to plan for which components would need to be improved  
22 upon.”<sup>66</sup>

23 “Given the changes made to zoning and the changes in composition of the  
24 customer base as it tripled, Staff does not believe the Company acted unreasonably in  
25 relying on the design assumptions provided when the facility was first constructed.  
26 Likewise, Staff does not believe that the capacity of the plant was increased through any

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23 <sup>63</sup> *Id.* at 11.

24 <sup>64</sup> *Id.*

25 <sup>65</sup> *Id.* at 13.

26 <sup>66</sup> *Id.*

1 of the upgrades. Staff believes that the upgrades did exactly as the Company has  
2 suggested – improved system reliability.”<sup>67</sup> Ultimately, “Staff does not agree with  
3 RUCO’s recommended disallowance of plant. The PVWRF is currently used and useful  
4 in service to LPSCO customers and is currently in compliance with all applicable ADEQ  
5 and ACC requirements.”<sup>68</sup>

6 5. The City’s Attempt To Use The PVWRF Upgrades To Lower  
7 LPSCO’s Return On Equity Is Illegal, Improper And Not Supported  
8 By Substantial Evidence.

9 In its brief, the City of Litchfield Park is critical of LPSCO for not filing a rate case  
10 before completion of the 2008 Upgrades.<sup>69</sup> On this point, the City does nothing more than  
11 sling mud at LPSCO. The gist of the City’s argument is that LPSCO’s rate of return  
12 should be lowered to 7.5% because LPSCO filed its rate case at the same time the  
13 Company completed its Upgrades to PVWRF.<sup>70</sup> The City then argues that LPSCO’s  
14 “insensitivity” to ratepayers justifies a lower return on equity.<sup>71</sup> The City’s argument to  
15 lower LPSCO’s rate of return should and must be rejected for several reasons, some of  
16 which are discussed below in section III(B). The City does not argue that the Commission  
17 should adopt RUCO’s disallowance for the Upgrades.<sup>72</sup> Rather, the City suggests that  
18 LPSCO did something wrong in waiting for completion of the Upgrades to seek a rate  
19 adjustment.<sup>73</sup> That argument is factually unsupported and wrong. For the reasons noted  
20 above, the Upgrades occurred as a result of changed conditions at PVWRF which then  
21 resulted in operational challenges and the need for additional reliability and redundancy

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22 <sup>67</sup> *Id.*

23 <sup>68</sup> *Id.* at 13 – 14.

24 <sup>69</sup> City Br. at 9.

25 <sup>70</sup> *Id.* at 10.

26 <sup>71</sup> *Id.*

<sup>72</sup> *Id.* at 9 – 10.

<sup>73</sup> *Id.* at 9.

1 measures. LPSCO is not even remotely responsible for those changed conditions.  
2 Further, when those changed conditions and operational challenges occurred, LPSCO  
3 resolved the issues by installing the Upgrades.<sup>74</sup>

4 The City did not present any evidence, let alone substantial evidence, that the  
5 timing of the Upgrades caused any harm to ratepayers.<sup>75</sup> Rather, the evidence presented at  
6 trial was *undisputed* that it is standard practice for owners to build a plant based on  
7 reasonable design assumptions and at a lower cost, with incremental upgrades made as  
8 operational challenges arise.<sup>76</sup> From a ratepayer standpoint, that practice is beneficial. If  
9 the original design assumptions hold true as the plant reaches its design capacity, then  
10 additional upgrades would not be necessary. Ratepayers do not suffer any harm and avoid  
11 the possibility of paying for unnecessary plant.

12 Here, LPSCO operated PVWRF successfully until changed conditions made the  
13 Upgrades necessary in 2006-2007. The City's suggestion that LPSCO handled the  
14 Upgrades improperly is not well-taken. The evidence is undisputed that the Upgrades  
15 were not unusual in terms of timing or magnitude, and they were "certainly not of  
16 excessive cost."<sup>77</sup> As testified by both Mr. McBride and Mr. Jones, LPSCO's actions  
17 relating to the Upgrades were proper and good utility practice.<sup>78</sup> *Again, the City did not*  
18 *provide any engineering or other testimony in response to Mr. McBride or Mr. Jones.*

19 What's more, LPSCO's customers and the Commission demanded and required  
20 that LPSCO install the Upgrades.<sup>79</sup> The notion that LPSCO's rate of return should be

21 <sup>74</sup> Tr. at 46 – 48.

22 <sup>75</sup> *Id.* at 666:3-7.

23 <sup>76</sup> *Id.*

24 <sup>77</sup> *Id.* at 1283. *See id.* at 1359 ("This facility with the upgrades...is in the \$6 a gallon range. I believe  
25 Mr. McBride testified that a typical range could be in the \$9 to \$10 range. I have seen plants 8 to 10 to  
26 even \$12 a gallon. And so this is a – the all in price here is a very good cost...").

<sup>78</sup> *Id.* at 1326. *See also* Staff Br. at 13.

<sup>79</sup> Ex. A-35 at 5; Sorensen Dt. at 6 – 7.

1 lowered because the Company installed necessary, used and useful plant Upgrades, which  
2 were required by the Commission and customers alike, would give new meaning to the  
3 concept that no good deed goes unpunished and would constitute bad public policy.

4 **B. Other Rate Base Issues In Dispute With RUCO.**

5 1. RUCO's Phase II Expansion Disallowance Should Be Rejected.

6 In its closing brief, RUCO raises a new disallowance argument relating to PVWRF.  
7 Specifically, "RUCO recommends that any and all costs of expanding the plant should be  
8 excluded from rate base, including but not limited to the \$36,500 for the Phase II design  
9 report and the \$552,100 for the change order request."<sup>80</sup> The \$36,500 disallowance relates  
10 to the costs incurred by LPSCO for the Phase II Design Report prepared by PACE in  
11 August 2004.<sup>81</sup> RUCO's closing brief barely addresses that disallowance and does not  
12 add anything new on the issue. This disallowance should be rejected for the reasons set  
13 forth in LPSCO's opening brief—specifically, that (i) the \$36,500 in design costs relate to  
14 prudent utility planning, (ii) such design work was required by ADEQ regulations in order  
15 to obtain the APP modification for construction of the 2007-2008 Upgrades, and  
16 (iii) LPSCO was required by ADEQ and County guidelines to begin the design and  
17 planning process for Phase II of PVWRF once the facility reached 80% of capacity.<sup>82</sup>

18 As stated, RUCO asserts a new disallowance for \$552,100 relating to an  
19 August 28, 2007 Change Order Request for the Upgrades.<sup>83</sup> This new disallowance  
20 should be rejected for several, equally dispositive reasons. First and foremost, RUCO did  
21 not assert that disallowance in its pre-filed testimony, during the hearing or in its final  
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23 \_\_\_\_\_  
24 <sup>80</sup> RUCO Br. at 6 – 7.

25 <sup>81</sup> Rigsby Dt. at 4 – 5.

26 <sup>82</sup> See LPSCO Br. at 34 – 36.

<sup>83</sup> Ex. R-35.

1 schedules. RUCO made this argument for the first and only time in its closing brief.<sup>84</sup>  
2 This disallowance should first be rejected as untimely and for lack of disclosure prior to  
3 hearing.

4 Second, this disallowance should be rejected because RUCO once again has  
5 misinterpreted and misstated the facts. The August 28, 2007 change order that RUCO  
6 relies upon (Ex. R-35) was change order no. 3 for the Upgrade project.<sup>85</sup> Unfortunately,  
7 RUCO has misread the terms of that change order on several fronts. To start, RUCO  
8 claims that “the Company agreed to pay \$552,100 to McBride for *inter alia*, programming  
9 to configure a third 5 mgd ultraviolet filter (“UV”) to work with two existing 5 mgd UV  
10 units in a lead/lag/standby configuration; and technical work to allow two new SBR units  
11 being provided by Jet Tech to work in conjunction with existing SBR units currently  
12 operating on site to allow for operation of all four SBR units.”<sup>86</sup> Exhibit R-35, however,  
13 does not actually say that. Instead, in its entirety, Exhibit R-35 states:

14 BACKGROUND: Algonquin Water Services has asked MES to provide  
15 additional professional services regarding the Litchfield Park Sewer  
16 Company Palm Valley WRF Performance Improvements Design Project.  
17 The additional services include managing and coordinating the  
18 programming subconsultant (Wunderlich-Malec) for the systems integration  
19 of some of the new and existing plant processes. It is expected that this will  
20 be the first of up to three change orders for the overall programming work.  
21 This part of the work will include the following:

22 UV System: Provide temporary programming and graphics to allow new  
23 5MGD UV filter to act as primary UV filter while four existing 1.2 MGD  
24 UV filters act as emergency backup units; Provide programming and  
25 graphics to configure and operate second 5MGD UV filter to work with  
26 initial UV filter in a lead/lag configuration to provide necessary UV  
filtration. Existing units will remain as emergency backups; Provide  
programming to configure third 5MGD UV filter to work with initial two

<sup>84</sup> RUCO did introduce Exhibit R-35 on the last day of hearing, but RUCO did not disclose any argument relating to a \$552,100 disallowance until its closing brief, which prevented the Company from presenting evidence directly rebutting this frivolous assertion by RUCO.

<sup>85</sup> Ex. R-35.

<sup>86</sup> RUCO Br. at 6.

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units in a lead/lag/standby configuration. Provide demolition of logic and graphics for existing 1.2MGD UV filters.

SBRs: Provide programming and graphics interface necessary to allow two new SBR units being provided by Jet Tech to work in conjunction with two existing SBR units currently operating on site; Determine programming considerations to ensure that all four units may be placed into operation at the same time while meeting operational criterion to be provided by others (i.e. only one SBR may be in Decant mode at any given time.); Provide programming and graphics to allow the operator to select SBR's into or out of service as required. Possible operating scenarios range from any two SBR's active, to any three SBR's active, to all four SBR's active; Work with Jet Tech to determine how to provide interface into new SBR's for controlling operating parameters such as modifying setpoints and enabling or disabling entire units.

Digesters/ATADs: Modify existing code and graphics to change existing ATADs and Digester to operate as sludge holding tanks; Modify wasting routine to allow any SBR to waste to any of the three sludge holding tanks either through operator selection or automatically based on tank levels.

Centrifuge: Work with new centrifuge vendor to provide graphics interface to allow remote control of centrifuge. Work with all interested parties to define scope of control/interface to be provided.<sup>87</sup>

Based on that wording, RUCO argues that “[c]learly, McBride Engineering design expenses related to the Phase II expansion of the plant from two trains to four trains.”<sup>88</sup>

That argument is completely and utterly wrong. This change order did not include any design work for the future Phase II expansion of PVWRF. As stated on the change order itself, this work related to the “*Litchfield Park Sewer Company Palm Valley WRF Performance Improvements Design Project*.”<sup>89</sup> The description of services on Exhibit R-35 states that the change order was “programming....for the systems integration of

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<sup>87</sup> Ex. R-35.  
<sup>88</sup> RUCO Br. at 6.  
<sup>89</sup> Ex. R-35 (emphasis in original).

1 some of the new and existing plant processes.”<sup>90</sup> Essentially, Exhibit R-35 related to  
2 additional engineering work in order to complete the Upgrades.<sup>91</sup>

3 RUCO’s contention that the design work related to a fourth SBR train to be  
4 installed in the future illustrates RUCO’s complete misunderstanding of the Upgrade  
5 project. McBride did not engineer a fourth future SBR train to be added to the plant.  
6 Instead, McBride engineered a third SBR “train” as part of the Upgrades, which consisted  
7 of additional equipment and two digester tanks that were hydraulically connected to make  
8 the third SBR “train.”<sup>92</sup> In essence, the two digester tanks were converted to a third SBR  
9 train.<sup>93</sup> As designed by McBride, two sets of SBR equipment (e.g., aerators, mixers,  
10 decanters) needed to be provided and installed as part of the Upgrades. RUCO’s claim  
11 that Exhibit R-35 related to the future Phase II expansion of PVWRF is erroneous.

12 Finally and even worse, RUCO misconstrues the amount of this change order. In  
13 its closing brief, RUCO contends that LPSCO paid \$552,100 to McBride for additional  
14 engineering work relating to the future Phase II expansion of PVWRF.<sup>94</sup> Apparently  
15 RUCO didn’t actually read the change order, *which lists the change order amount as*  
16 *\$24,910.*<sup>95</sup> RUCO’s attempt to disallow \$552,100 in costs is misleading. LPSCO hired  
17 McBride to engineer and manage the multi-phase Upgrade project as a “construction

18 <sup>90</sup> *Id.*

19 <sup>91</sup> See email from B. McBride dated February 16, 2010, copy **attached as Reply Brief Exhibit 1.**

20 <sup>92</sup> *Id.*; Tr. at 185 – 186, 189.

21 <sup>93</sup> Tr. at 188 (“The third train was converted from two existing digester tanks... We just made a hydraulic  
22 connection, poked a hole in the wall, basically, to make them act as one tank. And so that was converted  
23 from two tanks into one SBR train.”). The third SBR unit added with the Upgrades originally was an  
24 anoxic tank with a wall running through it, thus dividing the tank into two separate parts/tanks. That wall  
25 could not be removed for structural reasons, so McBride hydraulically connected the two parts by poking  
26 holes in the wall to convert the two anoxic tanks into one SBR unit. PVWRF does not have a fourth SBR  
train and McBride did not design or engineer a fourth SBR train.

<sup>94</sup> RUCO Br. at 6 – 7 (“RUCO recommends that any and all cost of expanding the plant should be  
excluded from rate base, including but not limited to the \$36,500 for the Phase II design report and the  
\$552,100 for the change order request.”).

<sup>95</sup> Ex. R-35.

1 manager at risk,” which required McBride to design and engineer the Upgrades  
2 concurrently with the construction process, in an iterative manner.<sup>96</sup> As the Upgrade  
3 project progressed, LPSCO and McBride executed various change orders for additional  
4 design, engineering and programming work for the Upgrades. One of those change orders  
5 was Exhibit R-35 for \$24,910 in additional engineering and programming work relating to  
6 the UV unit and SBR Upgrades installed in 2007-2008.<sup>97</sup> *McBride did not perform any*  
7 *design or engineering work for the Phase II expansion and RUCO’s claims to the*  
8 *contrary are unsupported and disingenuous.*<sup>98</sup>

9           2.     Capitalized Affiliate Labor.

10           RUCO asserts that the Company’s supporting documentation for capitalized  
11 affiliate labor was “woefully inadequate.”<sup>99</sup> Therefore, RUCO wants to disallow over  
12 \$2.3 million of rate base.<sup>100</sup> This same documentation was adequate for Staff in this case.  
13 It was adequate for LPSCO’s independent auditors. It was adequate for APT’s  
14 independent auditors. It was adequate for RUCO’s auditors in two prior and two pending  
15 rate cases where support for capitalized affiliate labor, provided by the same affiliates,  
16 was never an issue. Nor has there been any issue over the vast majority, LPSCO suggests  
17 as much as 98 percent, of the tens of thousands of pages of documentation exchanged in  
18 this case. Only Ms. Rowell has an issue with the adequacy of the supporting  
19 documentation for capitalized affiliated labor. But not looking at supporting  
20

21 <sup>96</sup> See **Reply Brief Exhibit 1**. See also Ariz. Rev. Stat. § 34-101(4)(“Construction-manager-at-risk”  
22 means a project delivery method in which: (a) There is a separate contract for design services and a  
23 separate contract for construction services. (b) The contract for construction services may be entered into  
at the same time as the contract for design services or at a later time. (c) Design and construction of the  
project may be in sequential phases or concurrent phases...”).

24 <sup>97</sup> Ex. R-35.

25 <sup>98</sup> Tr. at 202 (“I am not aware of any design in existence for the 8.2 MGD plant.”).

26 <sup>99</sup> RUCO Br. at 8.

<sup>100</sup> RUCO Final Schedules 3, pages 2 and 3 of 4 (water) and pages 3 and 4 of 4 (wastewater).

1 documentation is not the same as not receiving supporting documentation. Ms. Rowell  
2 testified clearly that she only looked at invoices, not the additional supporting  
3 documentation.<sup>101</sup>

4 As Mr. Bourassa explained, with respect to every item of capitalized affiliate labor,  
5 Staff and RUCO were given the project name and date, the hours incurred by employee,  
6 the applicable labor rate, the payroll burden, the total cost, the related affiliate profit,  
7 which was later eliminated, and the applicable NARUC account.<sup>102</sup> RUCO appears to  
8 now be arguing that this information should not be considered because Mr. Bourassa did  
9 not do an audit and thus cannot “avow that the Company’s position is supported.”<sup>103</sup> But  
10 Mr. Bourassa was simply describing the nature of the information provided to support  
11 every plant item. Ms. Rowell didn’t challenge Mr. Bourassa’s testimony that this was the  
12 information she had available; again, she admitted she didn’t know what additional  
13 supporting documentation was provided.<sup>104</sup> That makes sense, given her repeated  
14 testimony that she only looked at the invoices. As for the claimed “significant  
15 discrepancies,”<sup>105</sup> Ms. Rowell admitted these were “small” mathematical discrepancies of  
16 less than 1 percent (well under \$15,000 combined).<sup>106</sup> That’s hardly significant and, like  
17 RUCO’s whole argument, it is woefully inadequate to justify removing \$2.3 million of  
18 rate base.

19  
20  
21  
22 <sup>101</sup> Tr. at 739:7 – 741:11.

23 <sup>102</sup> Bourassa Amended Rb. at 15:1-15; Ex. A-25.

24 <sup>103</sup> RUCO Br. at 7:15-17.

25 <sup>104</sup> Tr. at 739:13 – 740:7.

26 <sup>105</sup> RUCO Br. at 8:1-3.

<sup>106</sup> Tr. at 743:7-13.

1                   3.     Capitalized Repairs.

2             RUCO also seeks to remove nearly \$230,000 from rate base claiming these non-  
3 test year capital projects should have been expensed.<sup>107</sup> RUCO argues that the  
4 Company's capitalization policy is inconsistent, and that its witness' "audit" based  
5 testimony meets the burden of proof. RUCO is wrong on both counts. That the  
6 Company's position is consistent is actually illustrated by RUCO's brief. First, RUCO  
7 argues that Mr. Bourassa testified that costs that either extend the life of existing plant or  
8 have a benefit of more than one year should be capitalized.<sup>108</sup> Second, RUCO asserts that  
9 LPSCO responded in a data request that capital projects are capitalized and there is no  
10 dollar threshold.<sup>109</sup> Both of these reflect the Company's position – look at the nature of  
11 the project, not at what it cost, to determine whether it should be capitalized.

12             Moreover, although RUCO now asserts that Ms. Rowell undertook a detailed  
13 analysis of whether costs should be capitalized,<sup>110</sup> Ms. Rowell was unable to justify her  
14 decisions to expense items that had been capitalized.<sup>111</sup> She certainly could not reconcile  
15 the fact that third-party vendors don't characterize their invoices based on whether the  
16 cost is to be expensed or capitalized. These problems are not cured by Ms. Rowell's post-  
17 hoc reliance on the NARUC Manual section on retirements that makes no mention of the  
18 test for capitalization versus expense.<sup>112</sup> There is always a risk that a utility will "game  
19 the system" and capitalize projects prior to the test year and expense them in it. But that  
20 isn't RUCO's claim here, nor is it the Company's demonstrated practice, and if anything,  
21 it's RUCO gaming the system to remove \$230,000 of used and useful plant that the

22 <sup>107</sup> RUCO Br. at 11:1-4.

23 <sup>108</sup> *Id.* at 9:4-6.

24 <sup>109</sup> *Id.* at 9:9-13.

25 <sup>110</sup> *Id.* at 10:6-17.

26 <sup>111</sup> *E.g.*, Tr. at 714:3 – 715:4, 723:4 – 724:3.

<sup>112</sup> Exs. R-20 and R-21.

1 Company will have no other means to recover. Going forward, the Commission will be  
2 able to ensure that LPSCO doesn't "game" the system by requiring the Company to  
3 adhere to the policy it claims it has followed and will be followed.

4 **C. Rate Base Issues In Dispute With Staff.**

5 1. Staff's Position On The Deferred Regulatory Asset Puts LPSCO's  
6 Ratepayers At Risk.

7 LPSCO and RUCO agree that the costs of additional testing and legal costs  
8 associated with the ongoing Superfund site are reasonable and should be recovered from  
9 ratepayers.<sup>113</sup> Staff agrees these costs were and are being reasonably incurred, but Staff  
10 opposes recovery.<sup>114</sup> Staff's only reason for disallowing recovery of reasonably incurred  
11 costs is that the costs are not ripe for recovery.<sup>115</sup> Staff's reasoning is strained – operating  
12 expenses are ripe for recovery when incurred, and these costs straddle test years but are  
13 made ripe for recovery in this rate case by virtue of the Accounting Order, Decision  
14 No. 69912.

15 The fact that there is "potential" for future recovery does not preclude recovery  
16 now. There is also a potential for no future recovery. The plume may never reach  
17 LPSCO's wells, or it might be determined that LPSCO can't recover these types of costs  
18 from Crane by a court. In fact, as the Company's witness testified, it doesn't even appear  
19 that the testing and legal costs being incurred now are recoverable in litigation with  
20 Crane.<sup>116</sup> In contrast, LPSCO's costs are real; they are being incurred to make sure the  
21 water is safe and that the right to sue Crane, if necessary, for the cost of new wells is

22  
23  
24 <sup>113</sup> RUCO Br. at 7:3-10.

25 <sup>114</sup> Michlik Water Sb. at 6:17-21.

26 <sup>115</sup> Staff Br. at 8:1-2.

<sup>116</sup> Tr. at 383:17 – 384:5.

1 preserved. Staff agrees this is a reasonable cause to spend money, but Staff has not  
2 provided any reason for waiting.

3 Staff's assertion that recovery under the Accounting Order is somehow triggered  
4 when there are "proceeds" to offset costs is without merit.<sup>117</sup> All the order says is that if  
5 there are proceeds they will also be considered for an offset in a future rate case. This has  
6 never been in dispute, and had LPSCO known it would have been required to continue to  
7 incur and then carry costs for years, waiting for events that may never happen, and even if  
8 they do happen, may not result in recovery, LPSCO would not have sought an Accounting  
9 Order and would not have incurred costs to protect its water supplies and the legal rights  
10 against Crane. Nor will LPSCO have any reason to continue to incur these costs if Staff's  
11 position is adopted.<sup>118</sup>

12 2. Security Deposits Should Not Offset Rate Base Unless All  
13 Corresponding Adjustments Are Also Made.

14 LPSCO included meter deposits in rate base as an offset because meter deposits are  
15 funds that can be used by the Company for plant, specifically meters. The Company  
16 excluded security deposits, however, because these amounts are not normally a  
17 component of rate base in the absence of working capital.<sup>119</sup> RUCO agrees that security  
18 deposits should not offset rate base because these are not investor-supplied funds.<sup>120</sup>  
19 Staff, offering nothing but the opinion of its witness, disagrees.<sup>121</sup> This opinion is

20 \_\_\_\_\_  
21 <sup>117</sup> Staff Br. at 8:9-16. Staff's other argument, that this is simply a risk utilities take, is frivolous. *Id.* at 17  
22 – 25. This argument is new and was not supported by any testimony or other evidence. Had Staff  
23 attempted to present such evidence, LPSCO could have had a chance to present evidence showing that  
contamination from a Superfund site is hardly a normal business risk, and now that LPSCO faces such a  
unique and clear risk, including the risk of being denied recovery of reasonable costs, its return on equity  
should actually have been increased to account for this known, firm-specific risk.

24 <sup>118</sup> Sorensen Amended Rb. at 13:5-13; Tr. at 1226:14 – 1227:4.

25 <sup>119</sup> Bourassa Amended Rb. at 12:22-25.

26 <sup>120</sup> RUCO Br. at 2:14-18.

<sup>121</sup> Staff Br. at 9:5-9.

1 undermined by Mr. Michlik's failure to take into account interest until after the fact,  
2 failure to provide a basis for his position until after the fact, and continued failure to  
3 account for the receivable secured by the subject deposits. As such, Staff's rate base  
4 offset should be rejected.

5 3. Accumulated Deferred Income Taxes - Staff Has Not Met Its Burden  
6 Of Proof.

7 In three sentences, one of which is not supported by any citation, Staff argues for  
8 adoption of its deferred income tax calculation.<sup>122</sup> Staff does not explain how it came up  
9 with its deferred income tax calculation or even cite to any evidence that supports its  
10 adoption. Staff has failed to meet the burden of proof Staff must be required to sustain.  
11 Even Mr. Michlik admitted that it is not the Company's burden to prove Staff's case. Nor  
12 can LPSCO now disprove what Staff has failed to prove. Staff surely can't be allowed to  
13 sustain its burden by simply claiming its calculation is better because the Company  
14 changed its position.<sup>123</sup> Not when the Company's calculation was well explained and  
15 consistent with prior methodology approved by this Commission.

16 To begin with, ADITs change in a rate case each time the components of rate base  
17 change.<sup>124</sup> Thus, Staff's attempt to portray changes as unusual or unexpected fails.  
18 Second, the most significant change made by Mr. Bourassa was in its rebuttal filing when  
19 it modified its initial DIT calculation, which was based on a roll forward, to a roll back.  
20 This was done in direct response to Staff's position in the pending BMSC rate case that  
21 the deferred income tax calculation needs to be rolled backward.<sup>125</sup> Since Ms. Brown  
22 testified that her position is Staff's position, it is entirely unfair for Staff to now claim the

23 \_\_\_\_\_  
24 <sup>122</sup> *Id.* at 6:2-5.

25 <sup>123</sup> *Id.* at 6:2-3.

26 <sup>124</sup> Bourassa Rj. at 9:14 – 10:2; Tr. at 1224 – 1225.

<sup>125</sup> Bourassa Amended Rb. at 10:3-17.

1 Company has done something wrong in modifying its calculation.<sup>126</sup> There were no other  
2 material changes to LPSCO's DIT calculation, except to take into account all proposed  
3 adjustments to plant in service, accumulated depreciation, CIAC and AIAC.<sup>127</sup> Besides, it  
4 cannot be inherently wrong to change a DIT calculation – Staff changed its calculation  
5 both before and after the hearings in the BMSC case.<sup>128</sup> The Company cannot be blamed  
6 for Staff's refusal to make any effort to understand the Company's position.<sup>129</sup>

7 4. Staff's Unexplained After-Trial Adjustments Must Be Rejected.

8 In its brief, Staff recommends that more than \$170,000 of capital items be removed  
9 as expenses.<sup>130</sup> What Staff fails to explain is that this position reflects a change from its  
10 surrebuttal schedules, or why it changed its position, or why the Commission should adopt  
11 its position.<sup>131</sup> It is simply insufficient to just cite to Staff's final schedules and nothing  
12 more.<sup>132</sup> In this light, the Company cannot respond, and the Commission should not  
13 consider or adopt Staff's recommendation.

14  
15  
16  
17 <sup>126</sup> See Transcript from November 25, 2009 hearing at 746 – 748, *Black Mountain Sewer Corporation*,  
18 Docket No. SW-02361A-08-0609.

19 <sup>127</sup> Bourassa Rj. at 9:14 – 10:2. In rejoinder, Mr. Bourassa also corrected a calculation error in his deferred  
income tax calculation. *Id.* at 10:3-11.

20 <sup>128</sup> Compare Surrebuttal Testimony of Crystal S. Brown, filed November 9, 2009 in Docket No. SW-  
21 02361A-08-0609, at 8 – 9, with Supplemental Surrebuttal Testimony of Crystal S. Brown, filed November  
22 19, 2009 in Docket No. SW-02361A-08-0609, at 3:16-23, and Staff's Opening Brief, filed December 22,  
2009 in Docket No. SW-02361A-08-0609, at 18-19, and Staff's Reply Brief, filed December 22, 2009 in  
Docket No. SW-02361A-08-0609, at 10 – 11.

23 <sup>129</sup> Tr. at 1225:25 – 1226:4. Notably, when the Company offered to have Mr. Bourassa explain its  
methodology in detail, Mr. Michlik declined the offer. *Id.*

24 <sup>130</sup> Staff Br. at 10:6-10.

25 <sup>131</sup> Compare Staff Sb. Schedule JMM-WW7 with Staff Final Schedule JMM-WW7 and Staff Sb. Schedule  
JMM-W7 with Staff Final Schedule JMM-W7.

26 <sup>132</sup> *Id.* at ns. 41 and 42. LPSCO cannot explain Staff's citation by "*id.*" in these two footnotes.

1 **II. REPLY ON INCOME STATEMENT ISSUES**

2 **A. The Commission Should Approve The Central Office Cost Allocations**  
3 **To LPSCO.**

4 1. Total Disallowance Of The APT Costs Is Not Supported By  
5 Substantial Evidence.

6 In their closing briefs, Staff and RUCO seek to disallow 99% of LPSCO's Central  
7 Office Cost allocations from Algonquin Power Trust ("APT"), irrespective of the  
8 undisputed evidence that LPSCO provides high quality utility service at a reasonable  
9 cost.<sup>133</sup> In no uncertain terms, the services provided by APT are used by LPSCO in the  
10 provision of utility service to customers under the Liberty Water business model.<sup>134</sup>

11 Staff's and RUCO's primary dispute is not with the actual costs incurred by APT,  
12 but with the business model used by Liberty Water in providing utility service. Staff and  
13 RUCO believe that the costs incurred by APT do not benefit LPSCO's ratepayers.<sup>135</sup> That  
14 is Staff's and RUCO's primary, if not only, focus and it is without merit and ignores the  
15 obvious benefits to ratepayers. Staff premises its disallowance on its belief "that nearly  
16 all of the costs were obviously attributable to the operations of APIF or one of its  
17 affiliates."<sup>136</sup> RUCO opposes the APT costs because "the vast majority of the costs are  
18 inappropriate and undocumented."<sup>137</sup>

19 Rather than relying on any evidence in the record, Staff and RUCO are  
20 philosophically opposed to Liberty Water's business model. Staff and RUCO simply

21 \_\_\_\_\_  
22 <sup>133</sup> Staff Br. at 16 – 18; RUCO Br. at 13 – 17; Sorensen Amended Rb. at 7 – 10; Tremblay Rj. at 2 – 4, 8 –  
27, Ex. GT-RJ1; Bourassa Dt. at 15, 43; Bourassa Amended Rb. at 33 – 38, 42 – 45; Tr. at 421, 440 – 455,  
466 – 470, 472 – 473, 490 – 499; Exs. A-10, A-11, A-12; LPSCO Br. at Brief Ex. 1.

23 <sup>134</sup> Sorensen Amended Rb. at 7 – 10; Tremblay Rj. at 2 – 4, 8 – 27, Ex. GT-RJ1; Bourassa Dt. at 15, 43;  
24 Bourassa Amended Rb. at 33 – 38, 42 – 45; Tr. at 421, 440 – 455, 466 – 470, 472 – 473, 490 – 499.

25 <sup>135</sup> Michlik Wastewater Dt. at 15 – 16; Michlik Water Dt. at 16 – 17; M. Rowell Dt. at 12 – 13.

26 <sup>136</sup> Staff Br. at 17.

<sup>137</sup> RUCO Br. at 12.

1 don't believe that LPSCO's customers should pay for the services provided by APT at the  
2 corporate level. That's another way of saying that Staff and RUCO believe LPSCO  
3 doesn't need to incur those APT costs in providing utility services. Staff and RUCO have  
4 not provided one iota of evidence supporting that claim and those generic beliefs don't  
5 constitute substantial evidence. "Substantial evidence is evidence which would permit a  
6 reasonable person to reach the trial court's result."<sup>138</sup> Thus, a Commission decision must  
7 be "rationally based on evidence of substance."<sup>139</sup> "Mere speculation and arbitrary  
8 conclusions are not substantial evidence and cannot be determinative."<sup>140</sup> Moreover, the  
9 same evidence presented in this case also was presented to Staff and RUCO in the recent  
10 Black Mountain Sewer Company case. In that case, RUCO accepted the Company's  
11 central office cost allocations.

12 2. Staff And RUCO Have Not Demonstrated Any Justifiable Reason  
13 For Disallowing All Of The APT Costs.

14 In their closing briefs, Staff and RUCO don't apply any valid ratemaking standards  
15 or principles in denying affiliate costs. Staff's and RUCO's opposition to the APIF  
16 business model is not a valid reason to deny the APT costs. Further, Staff's attempt to  
17 manage how Liberty Water conducts business violates fundamental Arizona law, which  
18 prevents the Commission from dictating how a utility should run its business.<sup>141</sup>

21 <sup>138</sup> *Estate of Pousner*, 193 Ariz. 574, 579, 975 P. 2d 704, 709 (1999). See also *Denise R. v. Ariz. Dep't of*  
22 *Economic Security*, 221 Ariz. 92, 93-94, 210 P.3rd 1263, 1264-65 (App. 2009).

23 <sup>139</sup> *Tucson Elec. Power v. Ariz. Corp. Comm'n*, 132 Ariz. 240, 245, 645 P.3d 231, 237 (1982).

24 <sup>140</sup> *City of Tucson v. Citizens Utils. Water Co*, 17 Ariz. App. 477, 481, 498 P.2d 551, 555 (1972).

25 <sup>141</sup> See *Southern Pac. Co. v. Ariz. Corp. Comm'n*, 98 Ariz. 339, 343, 404 P.2d 692, 696 (1965) ("...plainly  
26 it is not the purpose of regulatory bodies to manage the affairs of the corporation. It must never be  
forgotten that, while the state may regulate with a view to enforcing reasonable rates and charges, it is not  
the owner of the property of public utility companies, and is not clothed with the general power of  
management incident to ownership.") (citations omitted).

1 Staff and RUCO must evaluate the corporate allocations within APIF's business  
2 model, which they have refused to do.<sup>142</sup> "Public utilities must be given the opportunity  
3 to prove the necessity and reasonableness of any expenditure challenged by a commission  
4 (or intervenor). To justify expenditure, a company must show that the expense was  
5 actually incurred (or will be incurred in the near future), that the expense was necessary *in*  
6 *the proper conduct of its business or was of direct benefit to the utility's ratepayers*, and  
7 that the amount of the expenditure was reasonable."<sup>143</sup>

8 a. Staff's Presumptive Denial Of The APT Costs Is Improper.

9 In its closing brief, Staff only dedicates two pages to the cost allocation issue,  
10 which illustrates Staff's presumptive denial of the APT costs. Staff's only basis for  
11 denying the APT costs is that "Staff's review indicated that nearly all of the costs were  
12 obviously attributable to the operations of APIF or one of its affiliates."<sup>144</sup> To say that is  
13 *not* substantial evidence is an understatement.

14 Staff has the burden of proof to support its proposed disallowances. In its closing  
15 brief, Staff doesn't mention the presumptive standard applied by Mr. Michlik, which  
16 required LPSCO "to demonstrate that the costs allocated down from APT are comparable  
17 to stand-alone utilities," a standard that has not been formally adopted by Staff.<sup>145</sup> Even  
18 worse, Mr. Michlik didn't make any effort to apply that analysis to LPSCO.<sup>146</sup>  
19 Mr. Michlik simply presumes that the cost allocations are invalid. This Commission has  
20 established that affiliate cost allocations "must be closely scrutinized in a general rate  
21

22  
23 <sup>142</sup> Sorensen Amended Rb. at 4 – 6; Tr. at 920 – 926, 931, 1181 – 1183, 1207 – 1209.

24 <sup>143</sup> The Regulation of Public Utilities, C. Phillips (1993) at p. 258 (emphasis added).

25 <sup>144</sup> Staff Br. at 17.

26 <sup>145</sup> Sorensen Amended Rb. at 3 – 5; Tr. at 1182 – 1184.

<sup>146</sup> Tr. at 1183.

1 case” but that “such heightened degree of scrutiny *may not amount to a presumptive*  
2 *disallowance of all costs incurred as a result of transactions with affiliates...*”<sup>147</sup>

3 Not only is such presumption improper, but the record demonstrates that LPSCO’s  
4 operating costs, which include the APT costs, are reasonable and comparable to other  
5 Arizona utilities. LPSCO prepared the charts attached as **Brief Exhibit 1** to the  
6 Company’s initial brief, which compare LPSCO’s operating costs to the operating costs of  
7 other Arizona water and sewer companies. On a per customer basis, LPSCO’s operating  
8 costs for the sewer and water divisions compare very favorably to the other Arizona water  
9 and sewer companies, including various stand-alone utilities.<sup>148</sup> For both divisions,  
10 LPSCO’s operating costs per customer rank below the average cost per customer of the  
11 entire comparable group of Arizona utilities.<sup>149</sup> These charts confirm that the APIF  
12 business model allows LPSCO to provide high quality utility service at a low cost.<sup>150</sup>

13 Put simply, Liberty Water’s shared services model provides substantial benefits to  
14 LPSCO and its customers. Staff’s presumption that the APT cost allocations artificially  
15 inflate LPSCO’s costs and expenses above industry norms simply isn’t true. Here, Staff  
16 and Mr. Michlik did *not* present any evidence showing that the APT costs were  
17 “obviously attributable” to APIF, whatever that means. Neither Staff nor Mr. Michlik  
18 bother to explain exactly what it means for costs to be “obviously attributable” to a parent  
19 company. Using such a subjective, undefined and unknown standard is a classic example  
20 of arbitrary and capricious action by an agency.

21 Not only does Staff apply incorrect ratemaking principles, but Liberty Water’s cost  
22 allocation methodology complies with the NARUC Guidelines on Cost Allocations and

23 <sup>147</sup> *Arizona Public Service Company*, Decision No. 55931, 91 P.U.R. 4th 337, 350 (April 1, 1988)  
24 (emphasis added).

25 <sup>148</sup> See LPSCO Br. at Brief Ex. 1.

26 <sup>149</sup> *Id.*

<sup>150</sup> Sorensen Amended Rb. at 7 – 10; Tremblay Rj. at 2 – 4, 8 – 27, Ex. GT-RJ1.

1 Affiliate Transactions. In its brief, Staff claims that “the Company did not identify the  
2 costs as direct or indirect as consistent with the guidelines provided by the National  
3 Association of Regulatory Utility Commissioners (“NARUC”) for Cost Allocations and  
4 Affiliate Transactions.”<sup>151</sup> LPSCO, however, has complied with the NARUC Guidelines  
5 by directly charging the Liberty Water costs and reporting all of the APT costs as indirect  
6 costs.<sup>152</sup>

7 Under the NARUC Guidelines, “indirect costs” are defined as “costs that cannot be  
8 identified with a particular service or product. This includes, but is not limited to,  
9 overhead costs, administrative and general, and taxes.”<sup>153</sup> The APT costs clearly meet that  
10 definition. Further, the Guidelines provide that “cost allocations” “can be based on the  
11 origin of the costs, as in the case of cost drivers; cost-causative linkage of an indirect  
12 nature; or one or more overall factors (also known as general allocators).”<sup>154</sup> The cost  
13 allocation methodology used by APIF and Liberty Water for LPSCO and the other  
14 Arizona subsidiaries follows these NARUC Guidelines.<sup>155</sup>

15 b. LPSCO Has Demonstrated That The APT Costs Are  
16 Necessary For LPSCO To Provide Utility Service And That  
17 The APT Costs Provide Direct Benefits To LPSCO And Its  
18 Customers.

18 In their closing briefs, Staff and RUCO focus only on whether the APT costs  
19 provide “direct benefits” to ratepayers without addressing whether “the expense was  
20 necessary in the proper conduct of [LPSCO’s] business.”<sup>156</sup> LPSCO has met its burden of  
21 proof on both points. With respect to the APT costs, LPSCO has shown that the

22 <sup>151</sup> Staff Br. at 16 – 17.

23 <sup>152</sup> Tremblay Rj. at 8-9, Ex. GT-RB1 at 2-5.

24 <sup>153</sup> NARUC Guidelines on Cost Allocations and Affiliate Transactions at 2.

25 <sup>154</sup> *Id.*

26 <sup>155</sup> Bourassa Amended Rb. at 36, 44.

<sup>156</sup> The Regulation of Public Utilities, C. Phillips (1993) at p. 258 (emphasis added).

1 contractual services expenses were actually incurred by APT/LPSCO, that those costs are  
2 reasonable and that the APT costs are necessary expenses under the APIF business model.  
3 The evidence presented by Mr. Sorensen, Mr. Bourassa and Mr. Tremblay on these issues  
4 demonstrates the necessity and benefits of the APT Central Office Cost allocations.<sup>157</sup>  
5 LPSCO also has shown that its operating costs compare very favorably to other water and  
6 sewer utilities.<sup>158</sup> The lack of any contrary evidence provided by or cited by Staff and  
7 RUCO reinforces these points.

8 LPSCO also has provided substantial evidence demonstrating that the APT services  
9 and costs directly benefit LPSCO and its customers. The underlying record shows that the  
10 APT costs are reasonable, necessary and beneficial to ratepayers by allowing LPSCO to  
11 provide high quality utility service. APT provides four types of services to LPSCO:  
12 (1) Strategic Management, which includes management fees, general legal services and  
13 other professional services; (2) Capital Access, which includes licenses/fees/permits, unit  
14 holder communications and escrow fees; (3) Financial Controls, which include audit  
15 services, tax services and trustee fees; and (4) Administrative/Overhead Costs.<sup>159</sup> Each of  
16 these categories of APT costs provides substantial benefits to LPSCO through access to  
17 capital and strong corporate governance.<sup>160</sup>

18 To start, Staff's and RUCO's suggestion that LPSCO does not benefit from the  
19 strategic management services provided by APT is meritless. Strategic management  
20 services are necessary for LPSCO to provide service and obtain capital financing under  
21 the APIF business model.<sup>161</sup> These services include legal expenses incurred by APT for

22 <sup>157</sup> Sorensen Amended Rb. at 7 – 10; Bourassa Dt. at 15, 43; Bourassa Amended Rb. at 33 – 38, 42 – 45;  
23 Tremblay Rj. at 2 – 4, 8 – 27, Ex. GT-RJ1; Tr. at 421, 440 – 441, 443 – 455, 469 – 473, 496 – 498.

24 <sup>158</sup> Ex. A-11; LPSCO Br. at Brief Ex. 1.

25 <sup>159</sup> Tremblay Rj. at 8 – 12, Ex. GT-RJ1.

26 <sup>160</sup> *Id.*

<sup>161</sup> Tremblay Rj. at 8 – 12, Ex. GT-RJ1; Tr. at 417 – 420.

1 general legal matters pertaining to all facilities owned by APIF, which are required in  
2 order for APIF to provide capital funding to individual utilities, without which the utilities  
3 could not provide adequate service.<sup>162</sup>

4 At hearing, Mr. Rowell conceded that LPSCO benefits from strategic management  
5 for utility services.<sup>163</sup> In its closing brief, however, RUCO denies these costs because  
6 LPSCO is not publicly traded in Canada and, therefore, “has no SEDAR filings” and  
7 because LPSCO does not file “audited financial statements necessitating legal review.”<sup>164</sup>  
8 Unfortunately, RUCO views LPSCO in a vacuum, rather than an entity within the Liberty  
9 Water business model. That argument is typical of RUCO’s superficial analysis.  
10 LPSCO’s need for those management and legal services from APT arises from the fact  
11 that APIF, as a publicly traded company, provides funding to LPSCO from the TSX.  
12 Under this business model, APIF can not provide capital funding to LPSCO without those  
13 strategic management and legal services, which clearly benefit LPSCO by enabling capital  
14 funding from the TSX.

15 The Strategic Management costs also involve professional services, including ERP  
16 System maintenance, benefits consulting, and other similar professional services.<sup>165</sup>  
17 These management services allow LPSCO to have an available source of capital funding  
18 and allow LPSCO to provide utility services at a cost cheaper than what such utilities  
19 could obtain on their own.<sup>166</sup>

20 RUCO acknowledges the benefits of the professional services, but seeks to allocate  
21 those costs equally among 70 facilities owned by APIF.<sup>167</sup> That cursory allocation

22 <sup>162</sup> Tremblay Rj. at 8 – 10, Ex. GT-RJ1 at 10.

23 <sup>163</sup> Tr. at 925.

24 <sup>164</sup> RUCO Br. at 13 – 14.

25 <sup>165</sup> Tremblay Rj. at 8 – 10, Ex. GT-RJ1 at 8 – 17.

26 <sup>166</sup> *Id.* at 23 – 25, Ex. GT-RJ1 at 9 – 10; Ex. A-10.

<sup>167</sup> RUCO Br. at 14 – 15.

1 method is improper because it does not consider the use of those services by individual  
2 facilities or regulated utilities. It stands to reason that LPSCO, with 33,000 total  
3 customers, will use more of those services than Black Mountain Sewer Company with  
4 2,000 customers or a landfill that hasn't been operated for many years.<sup>168</sup> RUCO's  
5 method will result in cross subsidization of services by utilities that don't use those  
6 services as extensively as other entities.<sup>169</sup> RUCO's use of 70 facilities also is flawed  
7 because APIF does not own seven of those facilities and an eighth facility is a landfill that  
8 hasn't been operated in over eight years, which means those eight facilities don't use any  
9 APT services.<sup>170</sup>

10 One critical issue that neither Staff nor RUCO address in their briefs is the benefits  
11 from access to capital facilitated by APT. In order for LPSCO to have continued access to  
12 capital markets, APT incurs a variety of costs for the benefit of the utilities, including  
13 LPSCO.<sup>171</sup> Mr. Rowell expressly agreed that LPSCO "benefit(s) from the equity" capital  
14 provided by APT.<sup>172</sup> Mr. Michlik likewise testified that it "is probably good for  
15 companies to have access to equity" capital.<sup>173</sup>

16 Again, the evidence is undisputed that APT incurs license costs and fees to ensure  
17 that APIF can participate in the TSX.<sup>174</sup> These licensing and permit fees are required in  
18 order to sell units on the TSX. The benefit of these costs is undisputed – LPSCO has  
19

20 \_\_\_\_\_  
21 <sup>168</sup> Tr. at 464 (Q. And that eighth facility you said is a landfill. Is that landfill, when was the last time that  
22 was operated? A. It has been years. The last when I was asking about it, it has been eight years since it  
23 has been operating....Q. And if it is not being operated, is it drawing any services from APT? A. No.”).

24 <sup>169</sup> *Id.* at 454 – 455.

25 <sup>170</sup> *Id.* at 461 – 464.

26 <sup>171</sup> Tremblay Rj. at 8 – 10, 23 – 28, Ex. GT-RJ1; Tr. at 931, 940 – 945, 947 – 950.

<sup>172</sup> Tr. at 924. *See also id.* at 940.

<sup>173</sup> *Id.* at 1197.

<sup>174</sup> Tremblay Rj., Ex. GT-RJ1 at 11 – 12.

1 access to capital only so long as APIF is able to access capital markets.<sup>175</sup> Under the  
2 APIF business model, the source of LPSCO's capital funding is investors who buy units  
3 in APIF. Those unit holders invest in APIF, and, in turn, provide capital funding to the  
4 regulated utilities.<sup>176</sup> In making investments in APIF, unit holders expect monthly  
5 distributions on the units they own. Escrow Fees to pay investor dividends are necessary  
6 to guarantee continued investor ownership and facilitate new investment in the Fund.<sup>177</sup>

7 Even so, RUCO claims that these escrow "expenses have no connection to the  
8 operation of LPSCO" and "no benefit to ratepayers."<sup>178</sup> That argument completely misses  
9 the point. The connection to LPSCO's operation is simple—LPSCO would not have  
10 access to equity capital if investors didn't buy units of APIF. Investors wouldn't buy units  
11 in APIF if they didn't get dividends, which means escrow fees for payment of dividends  
12 are a necessary cost of business.<sup>179</sup>

13 Similarly, unit holder communication costs are incurred by APT to comply with  
14 the filing and regulatory requirements of the TSX.<sup>180</sup> These disclosures are required by  
15 law.<sup>181</sup> Although RUCO disputes these costs on page 17 of its brief, Mr. Rowell testified  
16 that "communicating with the investors is something the APIF needs to do" and "publicly  
17 traded companies are required to provide, you know, communications with their  
18 investors."<sup>182</sup> Both Mr. Michlik and Mr. Rowell conceded at trial that access to capital  
19 from the TSX is beneficial to LPSCO.<sup>183</sup> On this record, it's undisputed that the services

20 <sup>175</sup> *Id.* at 24 – 27.

21 <sup>176</sup> *Id.* at 24 – 25, Ex. GT-RJ1; Tr. at 11 – 12.

22 <sup>177</sup> Tremblay Rj. at 24 – 25, Ex. GT-RJ1; Tr. at 443 – 444.

23 <sup>178</sup> RUCO Br. at 17.

24 <sup>179</sup> Tr. at 496.

25 <sup>180</sup> Tremblay Rj. at 24 – 25, Ex. GT-RJ1; Tr. at 440 – 441.

26 <sup>181</sup> *Id.*

<sup>182</sup> Tr. at 950.

<sup>183</sup> *Id.* at 470 – 472, 924, 1197.

1 provided by APT are necessary for LPSCO to have access to capital markets from  
2 APIF.<sup>184</sup>

3 Staff and RUCO also ignore benefits to LPSCO of Financial Control costs incurred  
4 by APT, which are required under the APIF business model. Under financial controls,  
5 APT incurs costs for tax services to ensure prudent tax filing, planning and  
6 management.<sup>185</sup> Taxes are paid on behalf of LPSCO at the parent level as part of a  
7 consolidated United States tax return. Tax services are provided by third parties,  
8 including KPMG and Grant Thornton.<sup>186</sup> Mr. Rowell admitted the necessity of these tax  
9 services at trial.<sup>187</sup>

10 In its brief, RUCO acknowledges the benefits of these tax services, but allocates  
11 only \$586.00 in tax costs to LPSCO. RUCO premises this minimal allocation on the fact  
12 that the tax invoices don't specifically mention LPSCO.<sup>188</sup> APT provides consolidated tax  
13 services to LPSCO which requires compliance with all United States and Canadian tax  
14 laws as a condition of LPSCO receiving funding from the Canadian capital markets.<sup>189</sup>  
15 The fact that a Grant Thornton invoice doesn't mention LPSCO is beside the point—those  
16 tax services still benefit LPSCO by ensuring that LPSCO, APT and APIF are in  
17 compliance with Canadian and United States tax laws.

18 Similarly, RUCO and Staff fail to recognize that audit services are necessary to  
19 ensure that LPSCO is operated in a manner that meets audit standards and regulatory  
20 requirements.<sup>190</sup> Without these services, LPSCO would not have a readily available

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21 <sup>184</sup> Tr. at 496 – 497.

22 <sup>185</sup> Tremblay Rj. at 19 – 21, Ex. GT-RJ1 at 12 – 14.

23 <sup>186</sup> *Id.*

24 <sup>187</sup> Tr. at 917 (“...I could say if APT is providing these tax services to LPSCO, then certainly they should  
be allowed.”).

25 <sup>188</sup> RUCO Br. at 12 – 14.

26 <sup>189</sup> Tr. at 407 – 409.

<sup>190</sup> Tremblay Rj. at 19 – 22, Ex. GT-RJ1 at 12 – 15.

1 source of capital funding.<sup>191</sup> These financial controls also are required by the rules of the  
2 TSX. Simply put, APIF cannot opt to avoid conducting an audit. Audits, investor  
3 communications, trustee fees and the like are necessities by virtue of APIF being publicly  
4 traded. At hearing, Mr. Rowell acknowledged the necessity and benefits of audit services,  
5 the Board of Trustees fees and other services for publicly traded companies.<sup>192</sup> Even so,  
6 RUCO allocates a grand total of \$818 in audit fees to LPSCO, a position which is contrary  
7 to Mr. Rowell's trial testimony.<sup>193</sup> Again, RUCO is hung up on the fact that LPSCO isn't  
8 mentioned on audit invoices from KPMG. But whether or not the KPMG invoice  
9 mentions LPSCO does not change the fact that all of those audit services are required in  
10 order for LPSCO to receive capital funding from APIF as a publicly traded income fund.

11 c. Staff's And RUCO's Focus On Invoices Is A Red Herring.

12 In their briefs, Staff and RUCO argue that LPSCO has failed to properly invoice  
13 and document the APT costs.<sup>194</sup> Both Staff and RUCO use that procedural argument to  
14 deny the APT costs. These arguments are meritless, circular and self-serving. Staff and  
15 RUCO are playing word games without analyzing the services actually provided by APT.

16 Neither Staff nor the Commission has ever stated exactly what type of  
17 documentation would satisfy them regarding affiliate costs. Staff's failure to define, let  
18 alone apply, a consistent standard is unfair to LPSCO and other utilities. Staff's and  
19 RUCO's use of alleged lack of documentation as a means to deny the APT costs also  
20 places form over substance. Whether or not an invoice from APT or a vendor mentions  
21 LPSCO does not change the nature of the service provided or the actual use of the APT

22 \_\_\_\_\_  
23 <sup>191</sup> *Id.*; Tr. at 496.

24 <sup>192</sup> Tr. at 920 ("...it is my position that to the extent that APT provides auditing services for LPSCO, they  
25 should be recoverable."); *Id.* at 924 ("There are expenses associated with being listed."); *Id.* at 944  
26 ("...publicly traded companies are required to have a board" of directors/trustees).

<sup>193</sup> RUCO Br. at 13; Tr. at 920, 924, 944.

<sup>194</sup> RUCO Br. at 15 - 16; Staff Br. at 15.

1 services by LPSCO. Presumably, LPSCO could cure this defect by word smithing the  
2 invoices to mention LPSCO. Of course, the services provided by APT would remain the  
3 same, which demonstrates Staff's and RUCO's non-sensical position on this issue.<sup>195</sup>

4 These "lack of documentation" arguments also are groundless. LPSCO answered  
5 numerous data requests on cost allocations. The Company provided all invoices over  
6 \$5,000 relating to these allocated costs and offered to provide further invoices below  
7 \$5,000 upon request. No such request came from either party. At trial, Mr. Tremblay  
8 presented a detailed paper entitled "Liberty Water Affiliate Cost Allocation  
9 Methodology," attached to his rejoinder testimony as Exhibit GT-RJ1, which explains in  
10 detail all of the affiliate cost allocations.<sup>196</sup> That paper and the thousands of pages of  
11 invoices provided by LPSCO more than document the APT costs.

12 To the extent Mr. Michlik or Mr. Rowell did not believe that they had adequate  
13 information to evaluate the APT costs or determine whether those APT services benefit  
14 LPSCO's customers, then they should have asked LPSCO to provide additional  
15 information. Specifically, Staff and RUCO should have advised LPSCO of exactly what  
16 additional information they needed to evaluate the APT cost allocations. Staff's and  
17 RUCO's failure to request such information is not a justifiable reason for penalizing  
18 LPSCO by denying all of the APT costs. To the extent Staff and RUCO claim that  
19 LPSCO has the burden of proof, it is patently arbitrary for Staff and RUCO to disallow  
20

21 \_\_\_\_\_  
22 <sup>195</sup> For example, RUCO argues that "the Company has provided no documentation of what specific work  
23 was done for the benefit of LPSCO ratepayers" on the invoices for management fees. RUCO Br. at 16.  
24 Apparently, RUCO (and presumably Staff) would be satisfied if the invoices provided by APT for  
25 management service mentioned LPSCO on the invoices and listed the management services provided. If  
26 APT revised its invoices as suggested by Staff, the services provided by APT, of course, would stay the  
same. Whether or not LPSCO is mentioned on the invoices does not change the fact that LPSCO uses the  
services provided by APT in providing utility services, including financing, strategic management, tax and  
audit services.

<sup>196</sup> Tremblay Rj. at Ex. GT-RJ1.

1 the APT costs for failing to meet Staff's or RUCO's unknown documentation standards.  
2 LPSCO can only meet its burden of proof if it knows what the burden of proof is.

3       Apparently Staff and RUCO want LPSCO to produce invoices demonstrating  
4 benefits of the services to LPSCO's ratepayers. That argument is silly. Invoices are not  
5 written for purposes of documenting that the service provided benefits a utility's  
6 ratepayers. Rather, an invoice is a bill for services provided. To the extent Staff or  
7 RUCO questions whether the services listed on the invoices benefit LPSCO, Staff and  
8 RUCO must analyze whether LPSCO uses the services provided by APT in providing  
9 utility services to customers, an exercise which RUCO and Staff simply refused to do.

10           3.     Staff And RUCO Have Not Considered The Consequences Of  
11                    Disallowing The APT Costs.

12       The Commission should be aware that Staff's and RUCO's disallowance of 99% of  
13 APT's affiliate costs is a clear rejection of the APIF business model. If that corporate  
14 service model is rejected, then the Commission will send Liberty Water a clear message to  
15 operate LPSCO differently, which undoubtedly will increase operating costs.<sup>197</sup> APIF and  
16 its other regulated utilities and unregulated businesses will not absorb the \$1 million  
17 allocation pool for the benefit of the Arizona utilities.<sup>198</sup>

18       When APT withdraws the various corporate services from LPSCO, the  
19 Commission, Staff and RUCO can expect the quality of services provided by LPSCO to  
20 decline and/or LPSCO's operating expenses to increase.<sup>199</sup> If that happens, RUCO and  
21 Staff will be getting exactly what they are asking for. Staff's and RUCO's opposition to a  
22 shared services model that is designed to and actually does deliver high quality utility  
23 service at a reasonable price simply doesn't make sense.

24       

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<sup>197</sup> *Id.* at 26 – 27; Tr. at 1212.

25       <sup>198</sup> Tremblay Rj. at 26 – 27.

26       <sup>199</sup> *Id.*

1 Even worse, Staff and RUCO have failed to address the impact of denying the APT  
2 costs on their cost of capital analyses. In developing information on cost of equity, both  
3 Staff and RUCO rely on data from publicly traded companies in deriving their cost of  
4 equity calculations, which are discussed later in this brief. Essentially, Staff and RUCO  
5 use financial information from Value Line, which is based on the annual reports filed by  
6 the various companies in the sample group. In those annual reports, the companies in the  
7 sample group report the various costs of being publicly traded on their respective  
8 exchanges as expenses, including director fees, taxes and audits.<sup>200</sup>

9 Unfortunately, however, Staff and RUCO do not adjust for denial of those  
10 expenses in their cost of capital analyses. It is arbitrary and unfair for Staff and RUCO to  
11 set LPSCO's cost of equity based on net earnings of the sample companies, which reflect  
12 corporate expenses of being publicly traded, but disallow LPSCO from recovering those  
13 costs in this case. Staff and RUCO have not produced any evidence showing that the  
14 regulatory jurisdictions for the sample companies have disallowed those corporate costs  
15 from inclusion in operating expenses of those companies. If those jurisdictions allow  
16 recovery of such corporate costs as operating expenses for the sample companies, then, by  
17 denying those same costs for LPSCO, Staff and RUCO would prevent LPSCO from  
18 earning its authorized rate of return.<sup>201</sup> As a result, Staff's and RUCO's denial of the APT  
19 costs would be a double whammy for LPSCO.

20  
21 <sup>200</sup> Ex. A-11. In Exhibit A-11, Mr. Tremblay established that companies such as San Jose Water,  
22 Connecticut Water, American States, Aqua America, California Water and Middlesex Water incur  
expenses associated with boards of directors, audit fees, and tax services. Tr. at 434-438.

23 <sup>201</sup> See, e.g., *In Re San Jose Water Co.*, 2004 WL 1947074 at ¶4.8 (Cal. P.U.C. 2004)(approving settlement  
24 which "includes an additional \$141,000 for 2004 and \$143,000 for 2005 for expenses related to  
25 compliance with the Sarbanes-Oxley Act. In 2002, Congress enacted the Sarbanes-Oxley Act. Among  
26 other things, section 404 of the Act requires companies to establish and certify their internal financial  
control systems by developing risk assessments and an internal audit plan....The new requirements of the  
Sarbanes-Oxley Act also have increased the audit fees associated with the standard financial auditing  
required of a publicly traded company.")

1                   4.     Staff's And RUCO's Allocation Methodologies Are Unsupported.

2             In its brief, Staff arbitrarily assigns 90% of the APT costs to APIF and 10% to  
3 LPSCO and the other regulated utilities and non-regulated facilities owned by Liberty  
4 Water.<sup>202</sup> To say the least, Staff does not provide any evidence supporting that allocation  
5 of the APT costs. And there isn't any rational basis for that allocation because all of the  
6 APT costs are incurred solely for the facilities owned by Liberty Water.<sup>203</sup> Staff and  
7 RUCO also fail to recognize that the APT costs can jointly benefit APIF and LPSCO.  
8 The NARUC Guidelines recognize this joint benefit concept in its definition of "common  
9 costs," which provides that common costs are "costs associated with services or products  
10 that are of joint benefit between regulated and non-regulated business units."<sup>204</sup>

11             To make matters worse, Staff allocates that 10% of the APT costs equally among  
12 all 71 facilities owned by APIF, which allocates 1.41% of the APT costs to LPSCO.<sup>205</sup>  
13 Both Staff and RUCO insist on allocating the Central Office Costs across 70/71 facilities  
14 owned by APIF, rather than the 63 facilities that actually use the APT services. Staff's  
15 and RUCO's insistence on allocating costs to 71 facilities defies logic. Mr. Tremblay  
16 expressly testified that APIF does not own seven (7) of those facilities and that those  
17 facilities do not use any APT services.<sup>206</sup> Further, Mr. Tremblay testified that APIF owns  
18 one additional facility that hasn't been operated for many years, which, of course, means  
19 that APT is not incurring any costs for a non-operable facility.<sup>207</sup> Staff's and RUCO's  
20  
21

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22 <sup>202</sup> Staff Br. at 17.

23 <sup>203</sup> Tremblay Rj. at 14 – 15.

24 <sup>204</sup> NARUC Guidelines at 2.

25 <sup>205</sup> Staff Br. at 17.

26 <sup>206</sup> Tr. at 461; Tremblay Rj. at 15-16.

<sup>207</sup> Tr. at 464; Tremblay Rj. at 15-16.

1 efforts to allocate costs to 71 facilities is an attempt to force APIF to cross-subsidize  
2 services provided to the Arizona utilities, which Staff concedes is improper.<sup>208</sup>

3 5. If It Does Not Agree With Liberty Water's Cost Allocation  
4 Methodology, The Commission Should Use Other Allocation  
5 Methodologies, Rather Than Deny All Of The APT Costs.

6 To the extent the Commission has concerns or hesitations about Liberty Water's  
7 allocation methodology, the Commission should not deny all of the APT costs, as  
8 suggested by Staff or RUCO. Any such decision would be short-sighted and detrimental  
9 to LPSCO's customers in the long run by resulting in increased costs of service and lower  
10 quality service. Instead, the Commission should advise Liberty Water and LPSCO of  
11 exactly what affiliate cost methodology is acceptable to the Commission.

12 Rather than deny all of the APT costs, the Administrative Law Judge and/or the  
13 Commission should consider other allocation cost drivers or methodologies, such as  
14 revenues, plant and operating costs. LPSCO provided evidence relating to those  
15 methodologies at hearing, including the pros and cons of each.<sup>209</sup> Using those drivers, the  
16 allocation percentages for the initial phase of the allocation to the 17 regulated utilities  
17 were 17.02% (revenue), 28.87% (operating costs) and 29.74% (plant).<sup>210</sup> When weighted  
18 equally, the result is an allocation of 24.96% to the 17 regulated utilities.<sup>211</sup> Liberty  
19 Water's use of facility counts as the initial allocation method complies with the NARUC  
20 Guidelines and results in a reasonable allocation of necessary costs to LPSCO.<sup>212</sup> Even  
21 so, if the Commission prefers a blended or alternative allocation methodology, or one of  
22

23 <sup>208</sup> Tr. at 1172 – 1174.

24 <sup>209</sup> *Id.* at 413 – 416, 456 – 460; Ex. A-12.

25 <sup>210</sup> *Id.*

26 <sup>211</sup> Ex. A-12 at 2.

<sup>212</sup> Bourassa Amended Rb. at 36, 44.

1 the options shown on Exhibit A-12, LPSCO is willing to consider such alternative  
2 methodology.<sup>213</sup>

3 At hearing, RUCO hinted at using a one-step allocation model based on revenue as  
4 an allocation methodology for Central Office costs.<sup>214</sup> The evidence presented at hearing  
5 established that revenue alone does not reflect how or to what extent various facilities use  
6 the APT services. For example, in 2008, the utilities division accounted for 29% of the  
7 total controllable operating costs of APIF while only producing 17% of the revenue,  
8 which shows that greater expenses are required to generate revenues for the regulated  
9 utilities as compared to electric facilities.<sup>215</sup> For LPSCO, a Central Office Cost allocation  
10 to LPSCO based on revenue would yield \$328,050.24 in APT costs allocated to LPSCO<sup>216</sup>  
11 in the test year; but may yield significantly higher results in future test years depending on  
12 the fluctuation in revenue of the non-regulated units.

13 6. The Other Red Herrings Raised By RUCO And The City Of  
14 Litchfield Park Are Frivolous And Should Be Ignored.

15 Unfortunately, in their closing briefs, the City and RUCO raise certain other  
16 concerns in an effort to muddy the waters on the APT costs as much as possible. These  
17 additional issues are nothing more than smear tactics and should be ignored. During the  
18 hearing, the City did not present any witnesses or evidence relating to the Central Office

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20 <sup>213</sup> Tr. at 103.

21 <sup>214</sup> *Id.* at 922 – 923.

22 <sup>215</sup> Ex. A-12. *See also* Tr. at 432.

23 <sup>216</sup> Tr. at 922 – 923. The total revenue from all 63 facilities owned by APIF in 2008 was \$206.99 million.  
24 Ex. A-12. According to its 2008 Annual Reports, LPSCO's total revenue in 2008 was \$13,300,133  
25 (\$6,904,953 for water and \$6,395,180 for sewer). LPSCO's total revenue is 6.4% of the total revenue of  
26 the 63 facilities owned by APIF (\$13,300,133/206,990,000). In LPSCO's Final Schedules, the total  
Central Office Cost pool is \$5,125,785. Allocating those costs based on revenue would yield \$328,050.24  
in APT costs allocated to LPSCO (5,125,785 x 0.064). It also should be noted that the total operating  
expenses for all 63 facilities is \$44,413,000. *Id.* As listed in the 2008 Annual Reports, LPSCO's  
unadjusted total operating expenses were \$13,197,603 (\$5,944,724 for sewer and \$7,252,879 for water),  
which is 29.7% of the total operating costs for all 63 facilities (13,197,603/44,413,000).

1 Cost allocations. Even so, on pages 7-9 of its closing brief, the City claims that  
2 “uncertainty” regarding allocation of costs justifies reducing LPSCO’s rate of return to  
3 7.5%.<sup>217</sup> The City’s suggestion that LPSCO’s rate of return should be lowered to 7.5%  
4 because of uncertainties regarding the cost allocations is ridiculous on several fronts.<sup>218</sup>

5 For starters, there simply isn’t any basis, let alone justification, for lowering  
6 LPSCO’s rate of return because the Company seeks to allocate the APT costs. The City  
7 does not cite any evidence or testimony from the record in its brief. Instead, the City  
8 makes several unsupported and bad faith arguments in an effort to lower the City’s water  
9 rates by any means necessary. For example, the City argues that Staff’s and RUCO’s  
10 “workload and the complexity and the evolving nature of the shared services model used  
11 for LPSCO virtually assures some improper expenses will be passed on to ratepayers.”<sup>219</sup>  
12 That argument is completely speculative, unsupported and, to a certain extent, insulting.  
13 The City has absolutely no basis for making that statement, especially since LPSCO has  
14 provided thousands of documents relating to the APT costs. LPSCO’s Central Office  
15 Cost Allocations have been completely open book. The City’s tactics should be seen for  
16 exactly what they are—an effort by the City to bad mouth a reputable utility company.

17 The City’s argument to lower LPSCO’s rate of return also must be rejected because  
18 it is illegal and contrary to Arizona’s rate setting framework.<sup>220</sup> The notion that the  
19 Commission “should also consider the inherent barriers created by complex organization  
20 structures, and the transparency and reasonableness of the allocation methodologies  
21 employed by the Company when establishing an overall rate of return” would re-write  
22 Article 15 of the Arizona Constitution and constitute reversible error.<sup>221</sup>

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23 <sup>217</sup> City Br. at 9.

24 <sup>218</sup> *Id.*

25 <sup>219</sup> *Id.* at 8.

26 <sup>220</sup> *See infra* at Section III(B).

<sup>221</sup> City Br. at 9.

1           The City also suggests that LPSCO did something wrong in including the Airlink  
2 expenses in the costs allocations from Liberty Water.<sup>222</sup> RUCO likewise implies that  
3 LPSCO attempted to hide the Airlink expenses.<sup>223</sup> Those claims couldn't be farther from  
4 the truth. The Airlink invoices were included in the invoices produced by LPSCO and  
5 were available for inspection and viewing by Staff, RUCO and the City. LPSCO's  
6 affiliate cost allocations have been completely transparent and open book. The Airlink  
7 invoices are a non-issue. After the Administrative Law Judge raised concerns about  
8 including those expenses in the cost allocations, LPSCO agreed to remove those costs to  
9 resolve the issue, rather than spending additional time at hearing debating the merits of  
10 those charges. The Airlink invoices should not cause any trepidation about the affiliate  
11 cost allocations. If anything, the Airlink invoices demonstrate that LPSCO has made an  
12 effort to provide Staff and RUCO with any and all information on the cost allocations.

13           Finally, on pages 15-16 of its brief, RUCO suggests that the APT management fees  
14 include added incentive fees. RUCO cites the APIF 2008 Annual Financial Results, but  
15 takes that report out of context. As stated in that report, "[i]n 2007 and 2008, APMI was  
16 paid on a cost recovery basis for all costs incurred and charged..."<sup>224</sup> RUCO then  
17 references the following statement from that 2008 financial report: "APMI is also entitled  
18 to an incentive fee of 25% on all distributable cash (as defined in the management  
19 agreement) generated in excess of \$0.92 per trust unit."<sup>225</sup>

20           Not surprisingly, RUCO misconstrues that sentence by suggesting that those  
21 incentive fees are allocated to LPSCO. LPSCO and the other facilities owned by APIF  
22 are not allocated additional incentive fees paid to APMI. Mr. Tremblay and Mr. Sorensen

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23  
24 <sup>222</sup> *Id.*

25 <sup>223</sup> RUCO Br. at 19.

26 <sup>224</sup> Ex. R-11 at 79.

<sup>225</sup> *Id.*

1 testified that the APT management fees are allocated to LPSCO at cost.<sup>226</sup> RUCO doesn't  
2 cite any evidence supporting this argument and it should be disregarded.

3 **B. Other Expense Issues In Dispute With Staff.**<sup>227</sup>

4 1. Liberty Water Offers Its Employees A "Reasonable Compensation  
5 Package."

6 Staff's opposition to "employee bonus" expense continues to rest on Staff's  
7 judgment that performance based pay is inherently unreasonable.<sup>228</sup> To begin with,  
8 performance based pay is not unusual; even the Commission uses at risk compensation.<sup>229</sup>  
9 Obviously, a state agency is different than a regulated utility with so-called "captive"  
10 ratepayers. But even RUCO recognizes that "bonuses" can be part of a "reasonable  
11 compensation package," and in this case, they are.<sup>230</sup> It's hard to imagine RUCO  
12 supporting a practice that is, as Staff claims, unfair to ratepayers.<sup>231</sup>

13 Staff did no analysis and does not question the amount of "bonus" pay. Instead,  
14 Staff excludes the total amount of at risk compensation paid during the test year claiming  
15 that this type of pay, in any amount, is not needed for service nor guaranteed to be paid.<sup>232</sup>  
16 If, as RUCO asserted, "bonuses" are part of a reasonable compensation package, then they  
17 are part of the cost of service and recoverable from ratepayers, assuming the amounts are  
18 otherwise reasonable. The Company has clearly shown that such payments are part of a

19 <sup>226</sup> Tremblay Rj. at 6; Sorensen Amended Rb. at 3 – 4.

20 <sup>227</sup> Staff also includes a section in its brief entitled *Potential Loss of Revenue from City of Goodyear*. Staff  
21 Br. at 18:1-5. The Company did not believe there still existed a dispute over inclusion of test year revenue  
22 from Goodyear in test year revenues. LPSCO also agrees with Staff that there is a potential for a loss of  
23 this revenue.

24 <sup>228</sup> *Id.* at 15:4-6.

25 <sup>229</sup> [http://www.azcheckbook.com/agency/view-object-group/code/CCA/year/2010/o](http://www.azcheckbook.com/agency/view-object-group/code/CCA/year/2010/objCode/6000/objGroup/6030)  
26 [bjCode/6000/objGroup/6030](http://www.azcheckbook.com/agency/view-object-group/code/CCA/year/2010/objCode/6000/objGroup/6030).

<sup>230</sup> RUCO Br. at 19 – 21.

<sup>231</sup> Staff Br. at 15:10.

<sup>232</sup> *Id.* at 15:7-10.

1 reasonable compensation program.<sup>233</sup> As for Staff's required "guarantee," the actual  
2 amount of "bonuses" paid could fluctuate from the test year to another. Again, so could  
3 the cost of power, the level of payroll taxes, the cost of benefits, the cost of testing  
4 wastewater, the costs of lawyers, accountants, inspectors, and the costs of pens, pencils  
5 and paper clips. It's the nature of ratemaking, and the reason the Commission uses a  
6 historical test year to predict the level of expenses when new rates will be in effect. If  
7 Staff felt the test year amounts failed to reflect the expense levels when rates would be in  
8 effect, Staff could have normalized to smooth out those fluctuations. Instead, Staff simply  
9 throws the meat out with the bone.

10 **C. Other Expense Issue In Dispute With RUCO.**<sup>234</sup>

11 1. Non-Recurring/Unnecessary Expenses.

12 RUCO recommends disallowing \$56,000 of purchased power expense for the  
13 water division because power generators "may have been used by the Company during the  
14 test year for construction."<sup>235</sup> But there is no evidence to support that contention. Instead,  
15 what the evidence shows is that the total power expense recommended by Staff and  
16 LPSCO is reasonable, including the fuel component. The test year is presumed normal,  
17 not "non-recurring," and RUCO's speculation does not rebut the presumption.

18 Similarly, on the "face" of "invoices," RUCO rejects a little over \$36,000 of  
19 operating expenses related to effluent disposal.<sup>236</sup> RUCO's arguments, however, are not  
20 supported by a single citation to evidence explaining the basis for this adjustment. Of  
21 course, RUCO's witness admitted she did not do any analysis of the Company's effluent

22 <sup>233</sup> *E.g.*, Sorensen Amended Rb. at 13:7-8; Sorensen Rj. at 13:3-15.

23 <sup>234</sup> RUCO also includes discussion of the "effluent fees" in the income statement section of its brief.  
RUCO Br. at 23 – 24. The Company's reply is set forth in the Rate Design section of this brief.

24 <sup>235</sup> *Id.* at 24:6-8. The citation in RUCO's brief was not omitted from this citation, it wasn't there. In fact,  
25 the Company does not recall any evidence in the record to support RUCO's assertion. Apparently, in  
addition to ignoring evidence, RUCO also believes it's okay to make up evidence.

26 <sup>236</sup> *Id.* at 24:10-20.

1 disposal practices, except read an invoice, so RUCO didn't have any evidence to cite.<sup>237</sup>  
2 Certainly, no evidence was presented to rebut the evidence showing these costs are  
3 reasonable and recurring.<sup>238</sup>

4 2. Bad Debt Expense For The Wastewater Division.

5 On the sole basis its witness' opinion that LPSCO's test year bad debt expense is  
6 "excessive," RUCO lowers this expense by nearly \$20,000 to a made-up level nearly  
7 \$40,000 lower than the test year amount.<sup>239</sup> Ms. Rowell's opinion contradicts all of the  
8 evidence, including the fact that the Company has averaged more than \$20,000 a year in  
9 this expense for the past three years.<sup>240</sup> Accordingly, the normalized bad debt expense  
10 level for the wastewater division recommended by Staff and LPSCO should be adopted.<sup>241</sup>

11 3. Dues and Memberships.

12 RUCO proposes to remove over \$10,000 of operating expenses said to be related to  
13 dues and memberships.<sup>242</sup> The sole basis for RUCO's recommendation is that RUCO  
14 disagrees with these costs.<sup>243</sup> This is not substantial evidence.

15 **D. LPSCO's Requested Rate Case Expense Is Reasonable.**

16 Staff "does not dispute the amount of rate case expense for either division."<sup>244</sup>  
17 However, Staff ignores the fact that the Company's witness took the stand on rebuttal and

18 \_\_\_\_\_  
19 <sup>237</sup> Tr. at 771:1 – 774:23.

20 <sup>238</sup> Bourassa Amended Rb. at 41:4-6. The "effluent clean up" is actually for maintaining the site where the  
21 Company legally disposes of effluent; an open farm field where the effluent is allowed to feed plants or  
22 crops or seep back into the ground and recharge the aquifer.

23 <sup>239</sup> RUCO Br. at 22 – 23.

24 <sup>240</sup> See Tr. at 766:13 – 767:4; *Id.* at 768:21 – 769:10 discussing Bourassa Rj. at 29:10-17.

25 <sup>241</sup> Company Final Schedules C-1, page 1 and C-2, page 6 (wastewater); Staff Final Schedules JMM-  
26 WW12 and JMM-WW18.

<sup>242</sup> RUCO Br. at 25:2-6.

<sup>243</sup> *Id.* Notably, RUCO again offers No citation to the record, except a vague reference to a prior cite to  
Ms. Rowell's schedules. See *id.* at 25:3.

<sup>244</sup> Staff Br. at 15:18.

1 updated the Company's estimate of rate case expense and the amount requested.<sup>245</sup>  
2 LPSCO requests rate case expense equal to \$250,000 per division, amortized over 3  
3 years.<sup>246</sup>

4 Staff continues to offer no more than its bare claim that it has been more than five  
5 years between rate cases for LPSCO to justify its recommended 5-year amortization.<sup>247</sup>  
6 Staff makes no effort to reconcile its position in this case with the similarly situated  
7 Global Water utilities for which Staff recommends three years. Nor does Staff make a  
8 case for its effort to set the Company up for a forfeiture of hundreds of thousands of  
9 dollars of prudently and necessarily incurred expense. LPSCO addressed each of the  
10 flaws in Staff's position in its brief and they need not be repeated herein.<sup>248</sup>

11 In contrast to Staff, RUCO recognizes that the Company increased its estimated  
12 rate case expense and the amount sought to be recovered.<sup>249</sup> Unfortunately, RUCO then  
13 spends a full two pages of its brief pointing the finger at LPSCO.<sup>250</sup> The Company could  
14 likewise spend two (or 20) pages reiterating how RUCO's actions and positions have  
15 directly led to the increased rate case expense. LPSCO then could address every one of  
16 RUCO's frivolous, post-trial claims of discovery abuse. LPSCO won't. Rate case  
17 expense is a difficult enough issue already. LPSCO presented evidence, at every stage, of  
18 why its rate case expense should be adopted.<sup>251</sup> In contrast, RUCO relies primarily on the  
19 belated allegations of counsel. The record clearly reflects the Company's concern over  
20 RUCO's counsel's unsupported claims of "dilatory" discovery tactics.<sup>252</sup> Even if RUCO's

21 <sup>245</sup> Tr. at 1375:18 – 1376:25.

22 <sup>246</sup> Company Final Schedule C-1, page 1 (water and wastewater).

23 <sup>247</sup> Staff Br. at 15:19-21.

24 <sup>248</sup> RUCO Br. at 74 – 76.

25 <sup>249</sup> *Id.* at 19:19-20.

26 <sup>250</sup> *Id.* at 20:11 – 22:14.

<sup>251</sup> Bourassa Dt. at 12:5 – 13:20; Bourassa Amended Rb. at 38:10 – 39:6; Tr. at 1375:18 – 1376:25.

1 counsel's allegations had merit, and they most certainly do not, RUCO waived its right to  
2 raise such issues by not raising them in the proper manner at the proper time.

3 Put bluntly, rate cases are tough, and they require a substantial investment of  
4 resources by the Company, the State and the other interested stakeholders. They are also  
5 important. LPSCO and its nearly 33,000 customers require just and reasonable rates and  
6 this is the only way to get there. Now, all LPSCO asks for is an expense level equal to  
7 roughly 80 percent of the total cost incurred and, a reasonable opportunity to recovery the  
8 authorized amounts.

### 9 **III. REPLY ON COST OF CAPITAL ISSUES**

#### 10 **A. Staff's And RUCO's ROEs Won't Do Enough To Attract Capital.**

##### 11 1. Reply to Staff.

12 The parties do not dispute that the goal of the cost of capital analysis is to set a cost  
13 of equity that will attract capital necessary for investment to the utility.<sup>253</sup> LPSCO also  
14 does not dispute Staff's bare description of its use of the DCF and CAPM<sup>254</sup>; the  
15 Company's disagreement with and differences in implementation are set explained in  
16 testimony and the Company's brief.<sup>255</sup> Staff also correctly points out that LPSCO is  
17 substantially smaller than any of the sample companies and not directly comparable.<sup>256</sup>  
18 LPSCO parts company with the arguments in Staff's brief though at the point Staff asserts  
19 that the Company's size argument fails because size only matters if LPSCO's parent,  
20 APIF, is compared to the sample companies.<sup>257</sup> Staff does not offer and the Company is  
21 not aware of any evidence to support this contention, but it's easily refuted. The

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22 <sup>252</sup> Tr. at 24:6 – 26:4.

23 <sup>253</sup> See generally, Staff Br. at 18:7-8; Rigsby COC Dt. at 8:22 – 9:5; RUCO Br. at 29.

24 <sup>254</sup> Staff Br. at 20:13 – 21:15.

25 <sup>255</sup> E.g., LPSCO Br. at 77:9 – 79:2; Bourassa COC Rb. at 5 – 15; Bourassa Rj. at 3 – 7.

26 <sup>256</sup> Staff Br. at 20:4-9, 21:20-23.

<sup>257</sup> Id. at 21:23 – 22:4.

1 Commission is not determining an ROE for APIF, it is setting rates for LPSCO. If those  
2 rates do not include an ROE that incents APIF to invest capital in LPSCO, over its other  
3 investment options, then it is the rates that have failed. Clearly, APIF has multiple  
4 investment options, including water and sewer utilities in states that are already perceived  
5 by APIF, the relevant investor in this picture, to provide better returns, faster and with less  
6 risk.<sup>258</sup>

7 If Staff's already too low 10 percent ROE doesn't attract capital, it certainly isn't  
8 going to be helped by Staff's unnecessary and overstated Hamada adjustment, which  
9 lowers Staff's recommended ROE to 9.2 percent.<sup>259</sup> Indeed, it is laughable that Staff  
10 actually seems to be suggesting that its Hamada adjustment is needed because LPSCO is a  
11 "stronger" investment than the sample companies because it has less debt.<sup>260</sup> The investor  
12 that believes that to be the case still has not been found. Until she or he is found, the  
13 range of ROEs the Commission should be considering in this case should start at Staff's  
14 recommended 10 percent ROE, pre-Hamada, and end with the Company's recommended  
15 12 percent.

16 2. Reply to RUCO.

17 As noted in LPSCO's closing brief, RUCO's recommended ROE of 9 percent is  
18 based on the exact same methodology as RUCO's recommended 8.22 percent ROE in the  
19 pending BMSC rate case.<sup>261</sup> RUCO's brief argues for adoption of Mr. Rigsby's analysis  
20 on that same basis and the Company will not repeat its opposition to that analysis at this  
21  
22

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23 <sup>258</sup> See Rebuttal Testimony of Gregory S. Sorensen, filed October 20, 2009 in Docket No. SW-02361A-08-  
24 0609, at 10:8 – 11:17.

25 <sup>259</sup> Bourassa COC Rb. at 5 – 10.

26 <sup>260</sup> Staff Br. at 22:11-15, 21 – 23.

<sup>261</sup> LPSCO Br. at 77:9 – 78:9.

1 time.<sup>262</sup> At bottom, if Staff's recommended 9.2 percent ROE is insufficient to attract  
2 capital, RUCO's 9.0 percent is even worse.

3 **B. The City Seeks Relief That Is Unsupported By Substantial Evidence**  
4 **And Unlawful.**

5 "LPSCO is a good company. City of Litchfield Park has never complained about  
6 the service that it has provided for its community that I am aware of. It has a good  
7 relationship with LPSCO, the city does, and it encourages the company to continue its  
8 investment in above bare minimum service. That is not what the city is looking for."<sup>263</sup> It  
9 is hard to believe the speaker of these words is also the signatory of the City's brief in this  
10 case. But they are, and apparently the City believes a punitive 7.5 percent cap on the  
11 authorized "ROE" will attract capital.<sup>264</sup> Either that, or as alleged above, its counsel is  
12 talking out of both sides of his mouth. Either way, neither the evidence nor law supports  
13 the City's request.

14 There is not a scintilla of evidence in the record to support an ROE of 7.5 percent –  
15 the City's witness did not perform any cost of capital analysis in this case and therefore  
16 has no basis to even make a recommendation regarding the appropriate ROE.<sup>265</sup> Thus,  
17 there is no evidence showing that a 7.5 percent ROE will instill confidence in LPSCO's  
18 financial soundness, allow LPSCO to attract capital, and allow LPSCO to perform its  
19 duties to provide service – the standard every ROE must meet to pass constitutional  
20 muster.<sup>266</sup> "If the rate does not afford sufficient compensation, the State has taken the use  
21 of utility property without paying just compensation and so violated the Fifth and

22 <sup>262</sup> See Bourassa COC Rb. at 15 – 23; Bourassa COC Rj. at 8 – 12.

23 <sup>263</sup> Tr. at 14.

24 <sup>264</sup> City Br. at 2:15-16.

25 <sup>265</sup> Tr. at 666:12-14.

26 <sup>266</sup> See, e.g., *Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia*,  
262 U.S. 679, 692-93 (1923).

1 Fourteenth Amendments.”<sup>267</sup> Here, the City has presented no evidence showing that a 7.5  
2 ROE would be comparable to a return that investors would expect to receive from  
3 investments with similar risk. Instead, the City’s attorney simply pulled a number out of  
4 his hat. Obviously, this isn’t substantial evidence.

5 Because it has no evidence to support its recommendation, the City argues that the  
6 Commission is endowed with “legislative discretion” that allows it to set an arbitrary  
7 equity return cap of 7.5 percent based on extraneous considerations such as  
8 “unemployment and a decimated housing market.”<sup>268</sup> The City is incorrect, however.  
9 The Commission’s ratemaking function is quasi-judicial in nature.<sup>269</sup> The Commission  
10 does not have the discretion, legislative or otherwise, to ignore the evidence and its own  
11 precedent in order to impose an arbitrary cap on utility equity returns.

12 The Arizona Constitution contains two separate rate-making provisions: Section 3  
13 of Article 15 gives the Commission the power to “prescribe” rates, while Section 14 of  
14 Article 15 requires the Commission to “ascertain” fair value, a quasi-judicial function.  
15 The exercise of quasi-judicial powers requires the Commission to consider evidence and  
16 make findings.<sup>270</sup> The evidence supporting the Commission’s decision must be  
17 substantial, and not arbitrary or speculative.<sup>271</sup> It is fundamental to the judicial concept of  
18 a fair hearing that “the one who decides shall be bound in good conscience to consider the

19 \_\_\_\_\_  
20 <sup>267</sup> *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 308 (1989). See also *Scates*, 118 Ariz. at 534, 578 P.2d  
at 615.

21 <sup>268</sup> City Br. at 2:1-5. The Company has already addressed the issue of the “economy” in its opening brief,  
22 and that legal discussion applies equally here to the City’s arguments. LPSCO Br. at 5 – 12. As for the  
23 City’s assertion that LPSCO has not engaged in cost cutting measures, like the State has done to address its  
budget crises, the City is wrong. City Br. at 2:5. The evidence shows the cost cutting measures the  
Company took when the economy was nearing or in recession. Tr. at 86 – 89.

24 <sup>269</sup> *State ex rel. Corbin v. Ariz. Corp. Comm’n*, 143 Ariz. 219, 223-24, 693 P.2d 362, 366-67 (App. 1984).

25 <sup>270</sup> *SW Gas Corp. v. Ariz. Corp. Comm’n*, 169 Ariz. 279, 284, 818 P.2d 714, 719 (App. 1991); *Corbin*, 143  
26 Ariz. at 224, 693 P.2d at 367.

<sup>271</sup> *City of Tucson v. Citizens Utilities Water Co.*, 17 Ariz. App. 477, 481-82, 498 P.2d 551, 555-56 (App.  
1972).

1 evidence, to be guided by that alone, and to reach his conclusion uninfluenced by  
2 extraneous considerations which in other fields might have play in determining purely  
3 executive action.”<sup>272</sup> Therefore, the Commission’s rate hearings “cannot be analogized  
4 the legislative process” in which lawmakers make policy decisions addressing the wants  
5 and needs of the citizenry.<sup>273</sup> In setting rates, the hearing resembles “that of a judicial  
6 proceeding,” not enacting legislation.<sup>274</sup>

7 As LPSCO has previously pointed out, rates must provide a reasonable return on  
8 the fair value of the rate base.<sup>275</sup> This necessarily means the Commission does not have  
9 discretion to reduce rates below what the evidence establishes as a reasonable return. The  
10 purpose of the fair value requirement is precisely to protect public service companies from  
11 unlawful appropriation of their property without due process and just compensation.<sup>276</sup>  
12 The fact that some consumers may be facing economic hardship is the reason that low  
13 income programs are provided and requested by the Company in this case; it does not  
14 mean the Commission is constitutionally authorized to appropriate LPSCO’s property by  
15 forcing LPSCO to provide service at inadequate rates.

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21 <sup>272</sup> *Corbin*, 143 Ariz. at 224, 693 P.2d at 367 (quoting *Morgan v. United States*, 298 U.S. 468, 480-81 (1936)).

22 <sup>273</sup> *Corbin*, 143 Ariz. at 223-24, 693 P.2d at 366-67.

23 <sup>274</sup> *Id.* at 224, 693 P.2d at 367 (quoting *Morgan v. United States*, 298 U.S. 468, 481 (1936)).

24 <sup>275</sup> *Ariz. Corp. Comm’n v. Ariz. Public Service Co.*, 113 Ariz. 368, 370, 555 P.2d 326, 328 (1976) (“The  
25 company is entitled to a reasonable return on the fair value of its properties . . . .”); *Consolidated Water  
26 Utilities v. Ariz. Corp. Comm’n*, 178 Ariz. 478, 482, 875 P.2d 137, 141 (App. 1994) (same).

<sup>276</sup> *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 149, 294 P.2d 378, 380 (1956) (citing *Smyth  
v. Ames*, 169 U.S. 466 (1898)); *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm’n*, 262 U.S.  
679, 690 (1923).

1 **IV. REPLY ON RATE DESIGN ISSUES**

2 **A. Staff And RUCO's Rate Designs.**

3 1. Staff Makes No Effort To Sustain Its Burden of Proof.

4 The sum total of Staff's defense of its proposed rate design is that its "rate design  
5 is typically a three-tier design with break over points and monthly minimum charges set at  
6 levels designed to encourage the efficient use of water."<sup>277</sup> Staff offers absolutely nothing  
7 more in support of its position. Of course, that's largely because there is no evidence in  
8 the record to support Staff's rate design. No evidence to explain how it was developed  
9 and no evidence to show it will encourage conservation. As foreshadowed in LPSCO's  
10 brief, Staff wants the Commission to adopt its rate design in this case because Staff says  
11 this is what Staff "typically" does.<sup>278</sup> This is hardly sufficient to meet the burden of proof.

12 Staff does attempt to challenge the proposed rate design by LPSCO and the City.  
13 Again, though, the sum total of Staff's argument is that "this rate design is deficient in that  
14 it has inequitable crossovers, i.e., usage levels at which the bill for a smaller meter is  
15 higher than the bill for a smaller meter."<sup>279</sup> This is also insufficient to rebut the evidence  
16 submitted by the Company and the City. Staff does not explain its position in any way,  
17 nor identify any of the alleged "inequities." In sum, all Staff offers is a conclusion  
18 unsupported by evidence. In contrast, the evidence does show that the City and LPSCO  
19 offer a rate design that the evidence shows will actually encourage conservation, and do  
20 so without the intentional and excessive revenue shifting that attends Staff's rate  
21 design.<sup>280</sup> As Staff recognizes, the Company's proposed rate design is also intended to

22 <sup>277</sup> Staff Br. at 23:19-20. Staff offers no citation to the record or any other authority for this bold  
23 declaration.

24 <sup>278</sup> See LPSCO Br. at 83:3-9.

25 <sup>279</sup> Staff Br. at 24:9-11 *citing* Tr. at 1036-37. Undersigned counsel has reviewed these pages of the record  
26 and finds no mention whatsoever of the rate design proposed by the City and the Company.

<sup>280</sup> LPSCO Br. at 81 – 82 *citing* Tr. at 642:18 – 643:1, 656:24 – 657:10, 660:14 – 664:20, 671:7 – 672:12,  
675:1 – 676:18.

1 better ensure revenue stability, thus minimizing the risk of another rate case because the  
2 Company does not have an adequate opportunity to earn its revenue requirement.<sup>281</sup> In  
3 fact, the City and Company's proposed rate design is the only rate design supported by  
4 substantial evidence in this rate case.

5           2.     Reply To RUCO On Rate Design.

6           RUCO's brief does not contain any discussion of its rate design for the water  
7 division. Therefore, LPSCO assumes RUCO has waived its recommended rate design for  
8 the water division and essentially adopted Staff's, which should be rejected for the reasons  
9 discussed immediately above. RUCO does reject the wastewater division's use of market  
10 rates for effluent in favor of a substantially higher fixed charge.<sup>282</sup> RUCO's argument  
11 relies solely on the opinion of its witness that the market-based effluent rate proposed by  
12 Staff and the Company is "excessively low" for a valuable commodity.<sup>283</sup> Ms. Rowell  
13 ignored all of the evidence that contradicted her opinion and recommendation, including  
14 evidence that effluent is also a noxious by-product of wastewater treatment that must be  
15 disposed of to customers that do have other alternatives for irrigation water.<sup>284</sup> In  
16 summary, market rates have provided the flexibility LPSCO and its customers need to  
17 dispose of effluent and promote groundwater conservation.<sup>285</sup> RUCO offers no reason to  
18 change. In truth, RUCO's substantial increase in effluent rates is actually counter-  
19 productive to the public policy of encouraging reuse of effluent.

20  
21  
22 \_\_\_\_\_  
23 <sup>281</sup> Staff Br. at 23:21-25. See also Tr. at 661:1-17, 663:11-13, 665:14-18, 669:14-23; Bourassa Rj. at Exs.  
TJB-RJ3 and TJB-RJ5.

24 <sup>282</sup> RUCO Br. at 23:14 - 24:2.

25 <sup>283</sup> *Id.* at 23:17-18.

26 <sup>284</sup> Sorensen Amended Rb. at 30:5-21; Sorensen Rj. at 2:3 - 3:11; Tr. at 794:21 - 795:8, 802:15 - 803:4.

<sup>285</sup> *Id.*



1 **ORIGINAL** and thirteen (13) copies  
2 of the foregoing were filed  
3 this 24th day of February, 2010, with:

4 Docket Control  
5 Arizona Corporation Commission  
6 1200 W. Washington Street  
7 Phoenix, AZ 85007

8 **Copy of the foregoing was hand delivered**  
9 this 24th day of February, 2010, with:

10 Dwight D. Nodes  
11 Assistant Chief Administrative Law Judge  
12 Arizona Corporation Commission  
13 1200 W. Washington Street  
14 Phoenix, AZ 85007

15 Kevin O. Torrey, Esq.  
16 Legal Division  
17 Arizona Corporation Commission  
18 1200 W. Washington Street  
19 Phoenix, AZ 85007

20 **Copy of the foregoing mailed/mailed**  
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**Litchfield Park Service Company**  
**Docket Nos. SW-01428A-09-0103, W-01427A-09-0104,**  
**W-01427A-09-0116, W-01427A-09-0120**

**REPLY CLOSING BRIEF**  
**February 24, 2010**

# **Brief Exhibit 1**

**WILEY, TODD**

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**Subject:** FW: Question

**Attachments:** 2007.04.20.PDF; Change Order Request No-0711-12.doc; Change Order Request No-0711-13.doc; Change Order Request No-0711-14.doc; Change Order Request No-0711-15.doc; Change Order Request No-0711-1.doc; Change Order Request No-0711-2.doc; Change Order Request No-0711-3.doc; Change Order Request No-0711-4.doc; Change Order Request No-0711-5.doc; Change Order Request No-0711-6.doc; Change Order Request No-0711-7.doc; Change Order Request No-0711-8.doc; Change Order Request No-0711-9.doc; Change Order Request No-0711-10.doc; Change Order Request No-0711-11.doc

---

**From:** Brian McBride [mailto:BMcBride@mcbrideengineering.net]

**Sent:** Tuesday, February 16, 2010 10:35 AM

**To:** WILEY, TODD

**Cc:** Tom Nichols

**Subject:** RE: Question

Todd,

To clarify, the SBR "train" that was added included equipment for two tanks that were hydraulically connected to make the single "train". Therefore, two sets of SBR equipment (e.g., aerators, mixers, decanters) needed to be provided and installed.

This change order was for additional engineering work that was required to complete the upgrades as detailed in the write-up.

The "original" contract was for \$420,720 (see attached). There were 15 change orders (also attached). This was a project with a "construction manager at risk" procurement format, so the design was completed as the job went forward and new unknowns were clarified. Each change order indicates its purpose in the write-up.

Please call me for clarification. Thanks.

Brian McBride

"Nearly all men can stand adversity, but if you want to test a man's character, give him power." -- Abraham Lincoln

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2/23/2010