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LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW

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P. O. Box 1448
TUBAC, ARIZONA 85646

(520) 398-0411
FAX: (520) 398-0412
EMAIL: TUBACLAWYER@AOL.COM

ADMITTED TO PRACTICE IN:
ARIZONA, COLORADO, MONTANA,
NEVADA, TEXAS, WYOMING,
DISTRICT OF COLUMBIA

OF COUNSEL TO:
MUNGER, CHADWICK, P.L.C.
DOCKET CONTROL

September 14, 2010

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Re: Sahuarita Water Company, L.L.C.
Docket No. W-03718A-09-0359

To Whom It May Concern:

Enclosed for filing in the above-referenced docket are the original and thirteen (13) copies of a Post-Hearing Initial Brief on behalf of the Sahuarita Water Company, L.L.C.

Thank you for your assistance. Please advise me if you have any questions.

Sincerely,

Angela R. Trujillo

Secretary

Lawrence V. Robertson, Jr.

Arizona Corporation Commission
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ARIZONA CORP. COMM
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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

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

ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF)
SAHUARITA WATER COMPANY, L.L.C.)
("SWC") FOR AN OPINION AND ORDER OF)
THE COMMISSION (i) DETERMINING THE)
FAIR VALUE OF THE UTILITY PROPERTY)
OF SWC FOR RATEMAKING PURPOSES, (ii))
FIXING A JUST AND REASONABLE RATE)
OF RETURN THEREON, (iii) APPROVING)
RATES AND CHARGES DESIGNED TO)
PRODUCE REVENUES SUFFICIENT TO)
RECOVER SWC'S COST OF SERVICE AND)
AUTHORIZED RATE OF RETURN, AND (iv))
PROVIDING FOR THE RECOVERY OF)
CERTAIN FINANCING AND OPERATING)
EXPENSES THROUGH A SURCHARGE AND)
A PASS-THROUGH TARIFF, RESPECTIVELY)

DOCKET NO. W-03718A-09-0359

POST-HEARING INITIAL BRIEF

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

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ARIZONA CORP. COMM
400 W CONGRESS STE 218 TUCSON AZ 8570*

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LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

LAWRENCE V. ROBERTSON, JR.
 ATTORNEY AT LAW
 P.O. Box 1448
 Tubac, Arizona 85646
 (520) 398-0411

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LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

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I.
INTRODUCTION

In the following sections of this Post-Hearing Initial Brief, Sahuarita Water Company, LLC (“SWC” or “Company”) will discuss various issues which are currently before the Commission for resolution within the context of the instant proceeding. SWC does not intend to address at this time each of the issues which have been raised in prepared testimony filed by SWC and the Commission’s Staff and/or oral testimony presented during the July 19-20 and July 23, 2010 evidentiary hearings. As to issues not addressed at this time, SWC reserves the right to address the same, as appropriate, by reliance upon the evidentiary record in the instant proceeding or through SWC’s Post-Hearing Reply Brief.

II.
WELL #23 IS “USED AND USEFUL” IN CONNECTION WITH SWC’S ONGOING PROVISION OF ADEQUATE AND RELIABLE WATER UTILITY SERVICE TO SWC’S CUSTOMERS, AND WELL #23 THEREFORE SHOULD BE INCLUDED IN RATE BASE IN THE INSTANT PROCEEDING

A. **Introduction**

A significant issue has arisen between SWC and the Commission’s Staff as to whether or not Well #23 is “used and useful” in connection with SWC’s provision of ongoing adequate and reliable water service to SWC’s customers. SWC believes that Well #23 is essential for such purpose, whereas the Commission’s Staff contends that it is not.

Central to this dispute is the relevance of A.A.C. R18-5-501 et seq. in connection with a determination of whether Well #23 is used and useful. Also relevant from SWC’s perspective are (i) other water system design criteria recognized by federal and state agencies and the water utility industry in the United States, and (ii) the age and condition of SWC’s other wells (Well #14 and Well #18).

In the following subsections of this Section II, SWC will discuss these various considerations. The discussion will begin with an identification of areas where SWC and the

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

Commission's Staff appear to be in agreement, and then proceed to a discussion of the areas of disagreement and the conclusions SWC believes should be reached.

B. Areas of Agreement Between SWC and the Commission Staff.

Based upon SWC's review of the prepared testimony of the parties upon the subject of Well #23, and the transcripts from the July 19-20 and 23, 2010 evidentiary hearings, it would appear that SWC and the Commission Staff are in agreement as to the subject areas depicted in the table set forth below:

Criteria	Accepted Value
Total 2008 Test Year units	4,670 units
Average Day Peak Month (ADPM)	358 gpd per unit = 0.249 gpm/unit
Peak Daily Demand (PDD)	427 gpd/unit = 0.30 gpm/unit
Well No. 14 and Well No. 18, operating together	1,550+1,250 gpm = 2,800 gpm
Well No. 18, operating alone	1,450 gpm
Well No. 14, operating alone	1,750 gpm

It is the manner in which this information is used, and the extent to which additional facts and design criteria are considered, where SWC and the Commission Staff analytically diverge from one another and reach different conclusions as to whether or not Well #23 is "used and useful" in connection with SWC's water system operations.

C. Areas of Disagreement Between SWC and the Commission Staff.

1. The Role of A.A.C. R18-5-503(A) and (B)

The Commission Staff appears to accord an exclusive role to A.A.C. R18-5-503(A) and (B) in reaching the conclusion that Well #23 is not "used and useful" within the context of the instant proceeding. More specifically, the Commission Staff appears to rely on these two (2) subsections for both (i) determining storage capacity, and (ii) determining well capacity in connection with a water system adequacy analysis.¹ Whereas, it is SWC's position that A.A.C. R18-5-503(A) and (B), by their very terms, are applicable only to a determination of storage capacity;² and, in that regard, they prescribe minimum requirements of a general nature, and not

¹ Tr. 395, L. 15-Tr. 397, L. 2; and Exhibit S-3.

² Tr. 54, L. 25-Tr. 55, L. 11; Tr. 59, L. 15-Tr. 60, L. 24.

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 absolute requirements or a storage “ceiling” for all public water systems, as the following
2 excerpts demonstrate:

- 3 “A. The minimum storage capacity for a CWS or a noncommunity
4 water system that serves a residential population or a school
5 shall be equal to the average daily demand during the peak
6 month of the year. Storage capacity may be based on existing
7 consumption and phased as the water system expands.
8 B. The minimum storage capacity for a multiple-well system for a
9 CWS or a noncommunity water system that serves a residential
10 population or a school may be reduced by the amount of the
11 total daily production capacity minus the production from the
12 largest producing well.” [emphasis added]

13 Further supportive of SWC’s position in this regard is the following passage from A.A.C.
14 R18-5-502(A), which pertains to the subject of “Minimum Design Criteria:

15 “A public water system shall be designed using good engineering
16 practices.”

17 As SWC witness Mark Taylor, P.E., of WestLand Resources, Inc. testified during the July 19,
18 2010 evidentiary hearing, what constitutes “good engineering practices” in this context has
19 evolved with the passage of time. At the time that A.A.C. R18-5-501 et seq. was adopted, the
20 Arizona Department of Health Services Engineering Bulletin No. 10, “Guidelines for
21 Construction of Water Systems” (May 1978), was illustrative of such “good engineering
22 practices.” Additional standards have developed since then to supplement Engineering Bulletin
23 No. 10, which have been recognized by the United States Environmental Protection Agency, the
24 Ten States Standards and the Arizona Department of Environmental Quality’s “Arizona
25 Guidance Manual For Emergency Plan Development.”³ In that regard, as Mr. Taylor testified,
26 he has used these evolving standards throughout his twenty-five (25) plus years as a registered
27 Professional Engineer in several western states (including Arizona) in connection with the

28 ³ See Exhibit A-12 at Page 5, L. 7-Page 6, L. 17; and Tr. 87, L. 4-Tr. 90, L. 5. Attached hereto as Appendix “A” is
an excerpt from “The 2007 Ten States Standards” which recommends the production or well source design capacity
approach used by Mr. Taylor as a part of his well capacity analysis criteria. Subsection 3.2.1.1. specifically
addresses the issue here under discussion. In that regard, as Mr. Taylor observed during his testimony,

“... groundwater is the sole source. . .”

of water supply for SWC. See Tr. 61, L. 7-Tr. 62, L. 2.

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 determination and design of well capacity for public water systems;⁴ and, he has not utilized
2 A.A.C. R18-5-503(A) and (B) for that purpose because it would be improper to do so.

3 Succinctly stated, while A.A.C. R18-5-501 et seq. is silent itself with respect to the
4 calculation of well capacity for water system adequacy purposes, the aforesaid criteria to which
5 Mr. Taylor referred and which he used are illustrative of those “good engineering practices” to
6 which A.A.C. R18-5-502(A) makes reference. Further, A.A.C. R18-5-503(A) and (B) are
7 intended to be used only in conjunction with satisfaction of a suggested minimum storage
8 requirement. They were not meant to be used for purposes of taking a “credit” against storage
9 capacity in connection with the determination and sizing of well capacity, or for combining
10 storage with available well capacity to calculate the adequacy of a water system’s capacity to
11 serve its customers. In that regard, the error of the Commission Staff’s exclusive reliance on
12 A.A.C. R18-5-503(A) and (B) for purposes of determining both storage capacity and well
13 capacity in connection with a system adequacy analysis for SWC is demonstrated in Section
14 II(C)(2) below.

15 2. *Demonstration of Commission Staff’s*
16 *Erroneous Analytical Approach*

17 Using the subject areas of agreement information depicted in the table set forth in Section
18 II(B) above, and the minimum storage capacity methodology set forth in A.A.C. R18-5-503(A)
19 and (B), it is to be observed that the Commission Staff’s exclusive reliance on these two (2)
20 subsections results in a minimum storage requirement calculation for SWC for the 2008 test
21 period of a negative 416,140 gallons!

22 **PART A**

23 Standard Storage Requirement = ADPM = 358 gpd/unit x 4,670 units = 1,671,860
24 gallons

25 **PART B**

26 Minimum Storage Requirement = (ADPM – [total daily production capacity – production
27 of the largest well out of service])

28 ⁴ Tr. 81, L. 18-19; also, see Tr. 89, L. 1-Tr. 90, L. 5.

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 Minimum Storage Requirement = (ADPM – [Capacity of Well 14 and 18] – Well No. 14)
2 Minimum Storage Requirement = ADPM – (Capacity of Well No. 18)
3 Minimum Storage Requirement = (1,671,860 gallons - 1450 gpm x 1440 gpm/per day)
4 Minimum Storage Requirement = 1,671,860 gallons – 2,088,000 gallons
5 Minimum Storage Requirement = -416,140 gallons

6 Since a “negative” storage capacity is not physically possible, the above calculation
7 suggests that SWC’s water system is capable of operating with zero storage capacity. However,
8 the reality is that a water system with the 2008 test period load of 4,670 customer connections
9 simply cannot operate adequately and reliably with no storage. In fact, during periods of peak
10 hour demand on SWC’s water system, such demand would be much greater than the available
11 production capacity of Well #18, assuming that SWC’s large well (Well #14) is out of service
12 and Well #23 is excluded from the analysis. At that point, SWC would effectively “run out of
13 water”; and, SWC would no longer be capable of maintaining

14 “. . . a pressure of at least 20 pounds per square inch at ground level at
15 all points in the distribution system under all conditions of flow. . .,”

16 as prescribed by A.A.C. R18-5-502(B).

17 More specifically, utilizing (i) relevant Engineering Criteria set forth in the 2007 Water
18 System Master Plan developed for SWC by WestLand Resources, and (ii) relevant data from the
19 Areas of Agreement Table set forth on page 2 of this Post-Hearing Initial Brief, SWC’s peak
20 hour demand exceeds the one hour production capacity of Well #18 (with Well #14 out of
21 service and Well #23 assumed not to exist) by 44,694 gallons (or 131,694 gph – 87,000 gph =
22 44,694 gph). This calculation is derived in the following manner.

23 SWC’s Water System Master Plan Engineering Criteria utilize a ratio of peak-day to
24 average-day use of 2.0; and, a ratio of peak-hour use to average-day use of 3.2.⁵ Accordingly,
25 the ratio of peak-hour use to peak-day use is 1.6 (or 3.2/2.0 = 1.6). The Areas of Agreement
26 Table indicates that SWC’s Peak Daily Demand (PDD) is 427 gpd/unit or 0.30 gpm/unit. Based
27 on the ratio of peak-hour use to peak-day use of 1.6, and the PDD of 427 gpd/unit, the Peak
28 Hourly Demand (PHD) would be 0.47 gpm/unit (or 427 gpd/unit X 1.6 = 683 gpd/unit or 0.47

⁵ A copy of the cover page and pertinent Engineering Criteria portion of SWC’s 2007 Water System Master Plan is attached hereto as Appendix “B.”

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 gpm/unit). $0.47 \text{ gpm} \times 60 \text{ minutes} = 28.2 \text{ gallons per hour (gph)} \times 4,670 \text{ units} = 131,694 \text{ gph}$ of
2 demand. Well #18 has a production capacity of 1,450 gpm when operating alone. $1,450 \times 60$
3 minutes = 87,000 gph of production capacity for Well #18. $131,694 \text{ gph} - 87,000 \text{ gph} = 44,694$
4 gph of PHD deficiency for SWC's water system.⁶

5 Thus, it is abundantly clear from the foregoing that the Commission Staff's exclusive
6 reliance upon A.A.C. R18-5-503(A) and (B) for purposes of determining both storage and well
7 capacity adequacy on SWC's water system is erroneous and misplaced, at least as to SWC's
8 water system within the circumstances of the instant proceeding. Moreover, it is likely that the
9 Commission Staff's "one-size-fits-all" analytical approach would produce similar aberrational
10 results on at least some other water systems as well. Of particular relevance in that regard are
11 the following observations in a February 16, 2006 letter from Mike Redmond (Pima County
12 DEQ Water/Waste Programs Manager) to the then Operations Manager of Las Quintas Serenas
13 Water Co.:

14 "Per the Arizona Revised Statutes R18-5-503 Storage
15 Requirements, . . . "the minimum storage capacity shall be equal to
16 the average daily demand during the peak month of the year."
17 This is the minimum storage capacity typically required for public
18 water systems in order to provide adequate above ground storage.
19 This storage is required to provide peak capacity during the peak
20 hour demands through the summer months, and also emergency
21 storage when a large well is out of service. In addition to this
22 minimum storage capacity requirement, all fire flow requirements
23 needs to be in addition to this volume. The Arizona
24 Administrative Code also includes a caveat that states the
25 following; "The minimum storage capacity for a multiple well
26 system may be reduced by the amount of the total daily demand
27 minus the production from the largest producing well." While this
28 option may allow the water company to reduce the minimum
storage capacity required for water systems, typically using this
equation produces a negative net requirement of storage capacity
and from my personal experience this only works with very small

⁶ In that regard, see Mr. Taylor's testimony regarding such well production deficiency and its operational impact on SWC's system at Tr. 68, L. 10-Tr. 69, L. 24. Also, see Tr. 68, L. 15-Tr. 69, L. 4 as to why storage capacity is not a proper substitute for redundant well capacity on a water system which is predicated on a well redundancy design concept, as is the case with SWC. In that regard, also see Tr. 82, L. 22-Tr. 84, L. 19, and Tr. 91, L. 23-Tr. 93, L. 19. As Mr. Taylor therein noted, it would be inadvisable and inappropriate to now "deem" that SWC's water system is predicated upon a storage redundancy design concept, rather than the well redundancy design concept adopted at the Company's inception.

1 connection with its system adequacy analysis.⁹ The former is forty (40) years old, and the latter
2 is thirty-five (35) years old.¹⁰ This information is of critical importance in connection with any
3 meaningful capacity analysis of SWC's water system. As Mr. Taylor testified, the loss of a well
4 due to a casing failure can mean the loss of a well (and delay in any replacement well) for the
5 affected water utility's system for a period of six (6) months to one (1) year.¹¹ Moreover, Mr.
6 Taylor testified that Well #14 was actually out-of-service during the April 2010 to June 2010
7 time period due to an equipment failure and unavailability of the necessary replacement parts.¹²
8 In addition, both Mr. Taylor and Mr. Seamans expressed the opinion that a well casing failure on
9 either Well #14 or Well #18 within the next few years was quite likely, given the age of each
10 well.^{13 and 14}

11 Finally, Mr. Seamans testified that Well #23 had been a part of SWC's long-range system
12 planning since at least 2007, when it became apparent that another well (Well #17) was not
13 going to be usable, due to water quality problems;¹⁵ and, he indicated that Well #23 would have
14 been in service during the 2008 test period, but for a letter from ADEQ directing SWC not to
15 connect Well #23 to SWC's water system until the arsenic treatment facility for Well #14 and
16 Well #18 production had been placed into service, which did not occur until 2009.¹⁶

17 Clearly, these additional facts also are pertinent to any determination as to whether or not
18 Well #23 is "used and useful" in connection with SWC's ongoing provision of adequate and
19 reliable water service to its customers; and, equally clear is the fact that Commission Staff failed
20 to give any consideration to these facts.

21 **D. Summary.**

22 For the reasons discussed in Section II(A) through (C) above, the Commission should
23 conclude that Well #23 is "used and useful" in connection with SWC's provision of ongoing

24 _____
25 ⁹ Tr. 433, L. 7-12. In addition, Commission Staff also did not consider the Company's pumping and delivery
obligations to the Town of Sahuarita in connection with the Company's use of Well #14.

26 ¹⁰ See Exhibit A-12 at Page 8, L. 2-11; Tr. 53, L. 4-7; and, Tr. 269, L. 4-5.

27 ¹¹ Tr. 53, L. 25-Tr. 54, L. 16.

28 ¹² Tr. 55, L. 12-Tr. 56, L. 17; Tr. 70, L. 1-4; Tr. 71, L. 8-Tr. 72, L. 12; and Tr. 93, L. 20-Tr. 94, L. 4.

¹³ Tr. 55, L. 2-6.

¹⁴ Tr. 270, L. 24-Tr. 271, L. 7.

¹⁵ Tr. 274, L. 6-Tr. 279, L. 19.

¹⁶ Tr. 278, L. 11-22.

1 adequate and reliable water service to its customers, and Well #23 should be included in SWC's
2 rate base in the instant proceeding.

3
4 **III.**

5 **THE COMMISSION SHOULD EITHER REJECT THE COMMISSION STAFF'S**
6 **PROPOSED INCLUSION IN, AND REDUCTION FROM, RATE BASE OF**
7 **\$96,204 IN CUSTOMER SECURITY DEPOSITS; OR, IN THE ALTERNATIVE,**
8 **ADOPT THE COMMISSION STAFF'S PROPOSAL AND ALLOW RATEMAKING**
9 **RECOGNITION AND RECOVERY OF SWC'S ANNUAL INTEREST EXPENSE**
10 **ASSOCIATED WITH SUCH CUSTOMER SECURITY DEPOSITS**

11 This issue is well summarized in the following excerpt from the prepared Rebuttal
12 Testimony of SWC witness Bourassa:

13 "Staff recommends the inclusion of customer security deposits
14 totaling \$96,204 in rate base (a reduction in rate base). The
15 Company disagrees with Staff for three reasons. First, customer
16 security deposits are not capital provided by noninvestors. They
17 represent security for payment of receivables from customers and
18 are used as a means of controlling bad debt expense. Rate payers
19 benefit by lower bad debt expense. Second, if Staff truly
20 considered the security deposits as a source of capital then Staff
21 should have included the annual interest cost in operating
22 expenses. The annual interest costs are on the order of \$4,000 to
23 \$5,000 annually. Finally, the Company maintains a separate bank
24 account for customer security deposits and does not use this cash
25 for any other purpose but to refund security deposits. Again, this is
26 not non-investor capital. Security deposits are akin to prepaid
27 expense and materials and supplies inventory which are
28 components of working capital. The Company is not requesting
working capital in the instant case. However, prepaid expense at
the end of the test year was over \$2,600 and materials and supplies
were nearly \$104,000. If customer security deposits are included in
rate base, they should be offset with both prepaid expense and
materials and supplies. Rate base would increase by nearly
\$10,400 (\$2,600 plus \$104,000 minus \$96,204) rather than [the]
Staff proposed decrease to rate base of \$96,204."¹⁷

¹⁷ See Exhibit A-4 at Page 14, L. 21-Page 15, L. 15. Also, see Tr. 26, L. 15-Tr. 28, L. 7; and, Tr. 203, L. 24-Tr. 205, L. 13.

1 During the July 20, 2010 evidentiary hearing, SWC witness Marian Homiak confirmed
2 that Customer Security Deposits are intended by SWC to ensure payment for water service, and
3 to minimize the Company's risk exposure to bad debt.¹⁸ She further confirmed that SWC has
4 established a separate bank account for Customer Security Deposits, and described how that
5 bank account is managed by the Company in order to preserve the identity of those funds.¹⁹
6 Finally, she confirmed that SWC pays interest on Customer Security Deposits at the rate of six
7 percent (6%) per annum, and explained that the payment of such interest and the refund of
8 Customer Security Deposits is accomplished by means of a credit to the water bill of the
9 customer in question.²⁰

10 The Commission Staff's position on this issue appears to be predicated upon the belief
11 that Customer Security Deposit funds

12 ". . .are similar in nature to customer advances for construction. . .
13 [and] Like customer advances, the deposits are available to the
14 utility for use in support of its rate base investment (Source:
15 Accounting for Public Utilities, by Robert L. Hane, Gregory E.
Aliff, and Deloitte & Touche LLP)."²¹

16 However, during cross-examination, Commission Staff witness Jeffrey M. Michlik
17 acknowledged that the source material upon which he relied as support for this proposition was a
18 private firm publication, which is not the equivalent of nor entitled to as much weight as a
19 Financial Accounting Standards Board ("FASB") or a National Association of Regulatory Utility
20 Commissioners ("NARUC") directive.²² Similarly, Mr. Michlik was unable to confirm whether

21 ¹⁸ Tr. 349, L. 20-Tr. 350, L. 8. Also, see Tr. 525, L. 6-9 where Commission Staff witness Jeffrey M. Michlik
acknowledged this purpose.

22 ¹⁹ Tr. 350, L. 9-Tr. 352, L. 5.

23 ²⁰ Tr. 353, L. 6-Tr. 353, L. 3.

24 ²¹ See Exhibit S-7, at Page 10, L. 16-21. Also, see Tr. 525, L. 25-Tr. 526, L. 5.

25 ²² Tr. 526, L. 6-17. Conversely, NARUC's Rate Case Audit Manual recognizes that SWC's exclusion of customer
26 security deposits from consideration in connection with a determination of rate base is an acceptable method. In that
27 regard, SWC's witness Thomas J. Bourassa testified as follows:

28 "Second, the Rate Case Audit Manual, published by the National Association of
Regulatory Commissions ("NARUC") specifically sets forth three methods for
the treatment of customer security deposits. A copy of the relevant section is
included as Exhibit TJJ3-RB-1. One of the three methods set forth in the
NARUC guide is the method proposed by the Company in the instant case. That
is, rate base is not reduced by the customer security deposits and interest
expense associated with the deposits is treated as a below-the-line (or non-

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 or not NARUC had recognized for ratemaking purposes a “2007 Deloitte & Touche Rate-Base-
2 Formula Chart” on which Mr. Michlik sought to rely to support his assertion that

3 “. . .customer deposits are akin to advances in aid of construction. . ..”

4 and, thus, should be deducted from rate base.²³ Finally, Mr. Michlik also acknowledged during
5 cross-examination that the Commission does not have any rules which direct that Customer
6 Security Deposits are to be included in, and deducted from, rate base in ratemaking proceedings
7 for Class “B” water companies, such as SWC.²⁴

8 In the final analysis, and on the basis of the evidentiary record in the instant proceeding,
9 it appears that there are two (2) ways in which the Commission can resolve this issue. The first
10 approach would be to (i) accord no role to the \$96,204 of Customer Security Deposits in
11 connection with the determination of rate base in the instant proceeding; and, (ii) allow no
12 recognition of interest paid on such Customer Security Deposits amount as an operating expense.
13 The second approach would be to (i) include and thereafter deduct the aforesaid \$96,204 amount
14 from SWC’s rate base, as the Commission Staff recommends; and, (ii) recognize and allow
15 recovery of \$5,772 or six percent (6%) interest thereon as an operating expense.²⁵ As between
16 these two (2) alternatives, SWC prefers the former.²⁶

17 IV.

18 THE COMMISSION SHOULD RECOGNIZE INCOME TAXES ATTRIBUTABLE TO 19 SWC’S TEST PERIOD WATER UTILITY OPERATIONS AS AN OPERATING 20 EXPENSE FOR RATEMAKING PURPOSES IN THE INSTANT PROCEEDING

21 A. Introduction

22
23
24 operating expense). In fact, in my experience this has been the method
25 traditionally used by Staff and the Commission in the past. It has only been in
the past couple of years where Staff has changed its position on the treatment of
customer deposits.” [See Exhibit A-6 at Page 9, L. 21-Page 10, L. 8.]

26 ²³ Tr. 527, L. 5-Tr. 530, L. 15.

²⁴ Tr. 531, L. 4-25.

²⁵ See Tr. 224, L. 6-Tr. 225, L. 15 as to why the amount to be included in and deducted from rate base, and the amount upon which interest expense is to be calculated, should be identical.

²⁶ As Mr. Bourassa testified, each of these alternative ratemaking approaches is recognized by NARUC for ratemaking purposes, as is a third approach which neither SWC nor Commission Staff have suggested for the instant proceeding. Tr. 27, L. 5-Tr. 28, L. 2.

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 In the instant proceeding, SWC is specifically requesting that the Commission re-
2 examine the Commission's general policy to date of declining to recognize income taxes as an
3 operating expense for limited liability companies ("LLC"). In response, the Commission's Staff
4 has argued for a continuation of that policy as to SWC, and the Commission's Staff has cited the
5 Commission's decisions and reasoning in the Sunrise Water Co. (Decision No. 71445) and
6 Farmers Water Co. (Decision No. 71510) rate cases as authority for the Commission Staff's
7 position on this issue.²⁷ In that regard, the following excerpts from those decisions are pertinent
8 to the discussion set forth below in this Section IV of SWC's Post-Hearing Initial Brief.

9 "[1] Because it has long been our policy not to allow recovery of
10 these hypothetical income tax expenses for non-taxable pass-thru
11 entities, [2] because we recognize that C corporation subsidiaries
12 included in a parent corporation's consolidated income tax return
13 are different than an S corporation because they are actually
14 taxable entities, [3] because we have no documentary evidence
15 before us of Sunrise's income passed through to Mr. Campbell or
16 that Mr. Campbell has actually paid any income taxes on that
17 income, and [4] because Sunrise can easily become a C
18 corporation if it chooses to do so in order to obtain recovery of
19 income tax expenses in future rate cases, we will not allow Sunrise
20 to recover any income tax expenses in this matter. [Sunrise Water
21 Co. Decision No. 71445, at Page 37, L. 3-12] [brackets inserted
22 and emphasis added]

18 * * *

19 "This Commission has recently addressed the issue of the
20 allowance of income tax expense for a pass-through entity in the
21 Sunrise Water Co. rate case (Decision No. 71445). In that docket,
22 the Commission determined not to allow the recovery of
23 hypothetical income tax expense based on long-standing
24 Commission policy and because there was no evidence that the
25 utility actually passed income to the shareholder or that the
26 shareholder paid taxes thereon, and because the utility could easily
27 become a C-Corp. We will not deviate from Commission practice
28 with respect to the allowance of income tax expense in this case."
[Farmers Water Co., Decision No. 71510 at Page 11, L. 11-17]
[emphasis added]

²⁷ Tr. 178, L. 5-8. In that regard, both Sunrise Water Co. and Farmers Water Co. are sub-chapter "S" Corporations within the meaning of the United States Internal Revenue Code, whereas SWC is a limited liability company. However, each type of entity is subject to the aforesaid "general policy" of the Commission here under discussion.

1 In the following subsections of this Section IV, SWC will discuss each of the four (4)
2 analytical “pillars” bracketed and underscored above upon which the Commission’s reasoning
3 and decision in Sunrise Water Co. appears to be predicated. In turn, such discussion is also
4 applicable to and dispositive of the Commission Staff’s reliance upon the Commission’s decision
5 in Farmer’s Water Co., which in essence accepted the Sunrise Water Co. decision as precedent.

6 **B. The Income Tax Expense Attributable to SWC’s Water Utility Operations During**
7 **the 2008 Test Period Is Not “Hypothetical.”**

8 There is no dispute between SWC and the Commission’s Staff as to whether SWC’s
9 water utility operations during the calendar 2008 test period generated income attributable to
10 SWC for which SWC’s members incurred federal and state income tax liability. SWC clearly
11 did generate such income. Nor, is there a dispute between the parties as to whether SWC’s
12 members paid federal and state income taxes upon income that was directly attributable to
13 SWC’s water utility operations during the test period. Several members did in fact pay such
14 taxes, and in significant amounts.

15 Accordingly, SWC believes that it is incorrect, if not disingenuous, to characterize these
16 expenses as “hypothetical.” Such expenses do in fact exist. In addition, such expenses are in
17 fact directly attributable to the water utility operations of SWC during the test period. Finally,
18 the payment of such expenses by SWC’s members is a direct responsibility and consequence of
19 their ownership of SWC.

20 Thus, when examined in isolation, it is readily apparent that the first “pillar” of reasoning
21 upon which the Sunrise Water Co. and Farmers Water Co. decisions are predicated is without a
22 foundation in fact within the context of the instant proceeding. The federal and state income tax
23 expense arising from the water utility operations of SWC during 2008 is real, and a significant
24 portion of that expense was in fact borne by the owners of SWC.

25 **C. The Commission’s Past Policy of Limiting Ratemaking Recognition and Recovery of**
26 **Income Tax Expense to Entities Which “Are Actually Taxable Entities” Elevates**
27 **Form Over Substance, and Results In Inadequate and Discriminatory Ratemaking.**
28

1 The Commission's past policy of allowing ratemaking recognition and recovery of
2 income tax expense for a subsidiary C corporation, which does not file its own individual income
3 tax return, appears to be predicated upon the fact that the income of the subsidiary C corporation
4 "is subject to the corporate income tax."²⁸ Whereas, the income of an S corporation or an LLC
5 (such as SWC) is not, because they are "not a taxable entity."²⁹ SWC submits that this disparity
6 in treatment simply cannot be rationalized or reconciled with that regulatory precept which
7 requires that the owners of a regulated utility entity be allowed full recovery of reasonably
8 incurred expenses through ratemaking recognition of such expenses. Only through equivalent
9 ratemaking recognition and recovery can the owners of an S corporation's or LLC's lawful right
10 to fully recover their expenses of ownership (as well as the opportunity to earn a fair and
11 reasonable return on their investment in the regulated entity) be protected.³⁰

12 More specifically, the Commission's policy of limiting the ratemaking recognition and
13 recovery here in question to "taxable entities" represents a classical example of the proverbial
14 "elevation of form over substance"; and, the inevitable consequence of such elevation is an
15 emasculation of the aforesaid regulatory precept for no legitimate reason. In order to fully
16 implement that precept as to the issue here under discussion, the Commission should draw upon
17 the law enforcement advice to "follow the money"; and, in this context, the Commission by way
18 of analogy should "follow the income taxes, and ascertain if paid, and by whom."³¹

20 ²⁸ See Decision No. 71445 (Sunrise Water Co.) at Page 34, L. 9-13.

21 ²⁹ *Id.* at page 34, L. 8-9.

22 ³⁰ Citing Hope and Bluefield decisions. As SWC witness Thomas J. Bourassa observed in his prepared Rebuttal
23 Testimony on the subject of Cost of Capital,

24 "If the investor [in a pass-through tax entity] does not get reimbursed from the
25 non-tax paying entity, he/she effectively receives a negative return on his/her
26 investment." See Exhibit A-5 at Page 9, L. 18-20.

27 In that regard, as SWC witness David S. Cutler, CPA testified during the evidentiary hearing on July 19, 2010, SWC
28 does not reimburse its members for federal and state income taxes they pay on income attributable to SWC's water
utility operations. Tr. 111, L. 8-Tr. 112, L. 8; and, Tr. 113, L.8-Tr. 114, L. 7. Moreover, because of this fact and the
related "capital contribution" by its members which occurs, "in essence the water company is effectively paying the
income tax." Tr. 119, L. 18-24; and Tr. 120, L. 6-10.

³¹ As indicated in Section IV(D) below, the evidentiary record in this proceeding clearly establishes that federal and
state income taxes in an aggregate amount of \$254,771 were actually paid by SWC's owners on income directly
attributable to SWC's 2008 test period water utility operations. In this regard, see Tr. 102, L. 3-12; Tr. 106, L. 20-
Tr. 107, L. 5; and Tr. 107, L. 20-Tr. 108, L. 18.

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 In connection with the foregoing, in the instant proceeding the Commission's Staff
2 endeavored to buttress this distinction in ratemaking treatment by referring to the United States
3 Internal Revenue Service's website, and quoting from that website. More specifically, in his
4 prepared Surrebuttal Testimony, Commission Staff witness Michlik stated as follows, in an effort
5 to defend the favorable ratemaking treatment of C corporations vis-à-vis an LLC:

6 "The differing treatment has a very sound basis in federal tax law.
7 The IRS requires that [a]n LLC business entity must file as a
8 corporation, partnership or sole proprietorship."² [emphasis in
9 original]³²

10 However, Mr. Michlik's recitation from the IRS website on this point is incomplete. A
11 more complete recitation would appear as follows:

12 "The federal government does not recognize an LLC as a
13 classification for tax purposes. [Accordingly] An LLC business
14 entity must file as a corporation, partnership or sole proprietorship
15 tax return."³³

16 Moreover, nothing in the text from the IRS website upon which the Commission Staff relies
17 "requires" that the Commission utilize a different ratemaking approach as between C
18 corporations, on the one hand, and S corporations and LLCs, on the other hand, in connection
19 with the recognition of income taxes attributable to income arising from the operations of a
20 regulated utility. The federal government does establish various classifications for federal
21 income tax purposes. However, it does not presume to prescribe, nor does it in fact prescribe,
22 when and how the payment of such income taxes should be recognized for utility ratemaking
23 purposes.³⁴

24 Finally, during cross-examination, Mr. Michlik appeared to suggest that because of
25 potentially favorable income tax consequences associated with an S corporation or LLC status,
26 income taxes attributable to the business operations of such a business entity thus should not be
27 accorded ratemaking recognition:

28 ³² Also, see Tr. 556, L. 1-4, and Tr. 559, L. 18-Tr.560, L. 23. A copy of that portion of the IRS website to which
Mr. Michlik cited in Footnote 2 of his prepared Surrebuttal Testimony is attached to this Initial Post-Hearing Brief
as Appendix "D."

³³ See Appendix "D" hereto.

³⁴ Tr. 109, L. 4-11.

1 "I think what Staff is saying is that the company chose to
2 be treated as a pass-through entity, and as such this income can be
3 combined with the filing of ten other businesses. I can take that
4 income and combine it with my other ten businesses, and then pay
5 tax on that.

6 So -- and that is why maybe I elected to be treated as a
7 pass-through. And certainly there are advantages and
8 disadvantages of a corporate forum. If I select a C corp., then I will
9 be -- I get the double taxation, one on the dividend and then at the
10 corporate level. So if I choose a C [sic], this passes through to me
11 and then I can offset this either loss or profit with the other income
12 loss and profits from my other businesses."³⁵

13 This rationale should be summarily rejected for several reasons.

14 First, it in effect "punishes" the owners of an S corporation or an LLC for having selected
15 a form of business organization for the regulated entity in question because it might provide a
16 favorable effect on their overall liability for income taxes. Second, it disregards the fact that the
17 owner's decision as to the type of business organization cannot in any manner increase the
18 liability for income taxes otherwise attributable to the income of the regulated entity in question.
19 Thus, ratemaking recognition of those income taxes does not create a detriment to ratepayers
20 which would not exist if the regulated entity was not a tax-pass through entity.³⁶ Finally, by
21 denying such ratemaking recognition of income taxes attributable to operations of a regulated S
22 corporation or an LLC, the owners of that regulated entity are being denied that full recovery of
23 ownership expenses and the opportunity to earn a fair and reasonable return on their investment
24 to which they are legally entitled.

25 Accordingly, for the reasons discussed above in this Section IV(C), it is also apparent that
26 the second "pillar" of reasoning upon which the Sunrise Water Co. and Farmers Water Co.

27 ³⁵ Tr. 542, L. 2-11.

28 ³⁶ Moreover, as SWC witness Mr. Bourassa also observed in his prepared Rebuttal Testimony on the subject of Cost of Capital,

"To consider the individual investor's other taxable income and tax deductions in how much income tax should be recovered by SWC or any other tax pass-through utility would result in cross-subsidization of the investor and rate payers which should not be countenanced by this Commission. This is why income taxes for tax-paying utilities (C-Corporations) are computed on a stand-alone basis even when they are owned by and file consolidated tax returns with a parent entity. It should be no different for tax pass-through utilities (S-Corporations or Limited Liability Companies)." See Exhibit A-5 at Page 10, L. 6-13. [emphasis added]

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 decisions are predicated is also flawed, as is the Commission Staff's reliance on the aforesaid
2 IRS website. Succinctly stated, there is no legal or logical rationale to support the Commission's
3 past policy of recognizing income taxes as an operating expense for C corporations for
4 ratemaking purposes, but denying such recognition when the public service corporation in
5 question is an S corporation or an LLC.

6 **D. The Evidentiary Record In the Instant Proceeding Indisputably Establishes (i) That**
7 **the Income Attributable to SWC's Business Activities During the 2008 Test Period**
8 **Was Reported to SWC's Members, As Required by Law; and, (ii) That Federal and**
9 **State Income Taxes Were Paid On a Substantial Portion of Such Income, As**
10 **Required By Law.**

11 The evidentiary record in the instant proceeding indisputably establishes that the income
12 attributable to SWC's business activities during the 2008 test period was reported to SWC's
13 members, as required by law; and, that federal and state income taxes were paid on a substantial
14 portion of such income, as required by law. These facts were unequivocally demonstrated by the
15 prepared Rebuttal Testimony and the prepared Rejoinder Testimony of SWC witness David S.
16 Cutler, CPA, as well as in his oral testimony during the evidentiary hearing on July 19, 2010.³⁷
17 Moreover, Commission Staff witness Michlik acknowledged that the income which was the
18 subject of such reporting and payment of income taxes was "attributable to the water utility
19 operations" of SWC.³⁸

20 In the Sunrise Water Co. decision, the third "pillar" upon which the decision's reasoning
21 was predicated was the absence of any documentary evidence to demonstrate that (i) the
22 Applicant's test period income had been "passed through" or reported to its owner, and (ii) any
23 income taxes had been paid on such income. In this proceeding, the evidence of record
24 (including documentation) unequivocally demonstrates (i) the requisite reporting of SWC's 2008
25 test period income to its owners, and (ii) the payment of federal and state income taxes on a
26 significant portion of such income. Accordingly, this "pillar" of reasoning is either inapplicable
27

28 ³⁷ See Exhibits A-15 and A-16. Also, Tr. 98, L. 14-Tr. 108, L. 18; and Tr. 109, L. 12-Tr. 110, L. 5.

³⁸ Tr. 543, L. 2-7 and Tr. 543, L. 18-25.

1 in this instance, or its “requirements” have been fully satisfied. Either way, it cannot and should
2 not be used as a basis for denying ratemaking recognition and recovery as an operating expense
3 of income taxes attributable to SWC’s 2008 test period operations.

4 **E. The Commission’s Past Policy of Limiting Ratemaking Recognition and Recovery of**
5 **Income Tax Expense to C Corporations Has The Impermissible Effect of Dictating**
6 **to The Owners of Public Service Corporations The Form of Business Organization**
7 **They Should Select.**

8 The fourth “pillar” of reasoning underlying the Sunrise Water Co. and Farmers Water Co.
9 decisions is predicated upon the proposition that a non-C corporation public service corporation

10 “. . . can easily become a C corporation if it chooses to do so in
11 order to obtain recovery of income tax expenses in future rate
12 cases. . .”³⁹

13 This type of reasoning reflects a classic example of the “carrot and the stick” approach, as
14 applied to utility rate regulation. However, it blatantly ignores the fact that an income tax
15 liability arose from the business activities of a non-C corporation public service corporation, and
16 it cavalierly disregards the fact that income taxes were paid on a significant portion of such
17 income, which are the actual facts in the instant proceeding.

18 Moreover, it places the Commission in the posture of presuming to dictate to the owners
19 of a public service corporation what type of business organizational structure they should adopt,
20 without any demonstration by the Commission as to why one form of organizational structure is
21 beneficial (or more beneficial) from the perspective of the ratepayers than another. What form of
22 organizational structure might best benefit the owners of a public service corporation from an
23 overall income tax perspective is irrelevant, as long as the form of structure selected (i) does not
24 create a financial detriment to the ratepayers which would otherwise not occur, and (ii) does not
25 in any manner impair the ability of the entity in question to fully discharge its public service
26 obligations.

27
28 ³⁹ Decision No. 71445 at page 37, L. 10-12.

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 Accordingly, for the reasons discussed above, this fourth “pillar” of reasoning underlying
2 the Sunrise Water Co. and Farmers Water Co. decisions is also flawed; and, it should not be used
3 as a basis for denying ratemaking recognition and recovery as an operating expense of income
4 taxes attributable to SWC’s 2008 test period operations.

5 **F. Summary**

6 For the reasons discussed above in Sections (B) through (E) of this Section IV, SWC
7 submits that the Commission should (i) recognize income taxes attributable to SWC’s 2008 test
8 period water utility operations as an operating expense for ratemaking purposes in the instant
9 proceeding, and (ii) allow recovery thereof in the rates and charges to be authorized for SWC.⁴⁰

10 **V.**

11 **THE EVIDENTIARY RECORD IN THE INSTANT PROCEEDING CONTAINS**
12 **SUBSTANTIAL EVIDENCE SUPPORTING RATEMAKING RECOGNITION AND**
13 **RECOVERY OF THE SALARIES OF “NON-DEDICATED EMPLOYEES” (“NDE”)**
14 **ALLOCATED TO SWC FOR THE 2008 TEST PERIOD**

15 **A. Introduction.**

16 This issue involves the question of whether the salaries of employees of Rancho
17 Sahuarita Management Company (“RSMC”) who provided services to SWC on a part-time basis
18 during the calendar 2008 test period should be accorded ratemaking recognition as an operating
19

20 ⁴⁰ On a related issue, SWC is proposing “credit” to or reduction in rate base of approximately \$525,000 related to
21 Accumulated Deferred Income Taxes (“ADIT”). Mr. Bourassa described the reasoning underlying SWC’s proposal
22 in this regard as follows:

23 “. . .the Company is proposing ADIT for rate making purposes to insure a proper
24 matching of rate base, revenues, and expenses as the Company also proposes the
25 inclusion of income taxes in expenses. If income taxes are allowed in expenses
26 then ADIT should be recognized in rate base in order to account for the
27 difference between the allowed income taxes included in rates and the actual
28 income taxes paid. In the instant case, the ADIT is a liability (a reduction to rate
base) which means that the actual income taxes through the end of the test year
were lower than the income taxes included in rates. By including ADIT in rate
base the rate payers are given a “credit” for actual income taxes being lower that
[sic] they have paid in their rates. The credit or reduction in rate base amounts to
nearly \$525,000.” [See Exhibit A-4 at page 10, L. 19-Page 11, L. 5.]

In the event that the Commission does not accord ratemaking recognition and recovery of income taxes attributable to SWC’s water utility operations during the 2008 test period, then the aforesaid “credit” to or reduction of SWC’s rate base should not be adopted.

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 expense recoverable in SWC's rates. The allocated salary amounts in question, as well as the
2 NDEs involved, are listed in Appendix "C" to the prepared Rebuttal Testimony of SWC witness
3 Marian Homiak.⁴¹ The total amount of allocated NDE salaries at issue is \$100,831.⁴²

4 Briefly summarized, it is SWC's position that the services rendered to SWC during the
5 test period by the NDEs (i) provided "value" to the Company, (ii) directly contributed to the
6 efficiency and quality of service of SWC's operations, and (iii) were predicated upon appropriate
7 allocations of NDE base salaries which are in line with comparable water utility industry and
8 regional compensation standards. The Commission Staff asserts that (i) the services provided by
9 the NDEs during the test period were not necessary in the day-to-day operations of SWC, and (ii)
10 the salary allocations proposed by SWC have not been adequately substantiated.

11 **B. Whether or Not an "Affiliate" Relationship Exists Between RSMC and SWC,**
12 **Within the Meaning of The Commission's Affiliate Rules, Is Not Dispositive Per Se**
13 **of The Ratemaking Issue Here Under Discussion.**

14 In both the prepared Direct Testimony and prepared Surrebuttal Testimony of
15 Commission Staff witness Michlik, as well as in its cross-examination of SWC's witnesses Mark
16 Seamans and Ms. Homiak, the Commission's Staff devoted a great deal of effort to trying to
17 establish the existence of an "affiliate" relationship between RSMC and SWC. However, SWC
18 submits that whether or not an "affiliate" relationship exists between RSMC and SWC, within
19 the meaning of the Commission's affiliate rules, is not dispositive per se of the ratemaking issue
20 here under discussion. To the contrary, as Mr. Michlik acknowledged during cross-examination,
21 the relevance of such "affiliate" relationship as might exist, if any, would be in the area of that
22 burden of proof to be required of SWC on the ratemaking issue which is the subject of this
23 Section V.⁴³ In that regard, for the reasons discussed below, SWC submits that it has fully
24 discharged its probative burden.

25
26
27 ⁴¹ See Exhibit A-14 (Marian Homiak prepared Rebuttal Testimony).

28 ⁴² See Exhibit S-9 at page 13, L. 22-page 14, L.3 (Jeffrey M. Michlik prepared Surrebuttal Testimony).

⁴³ Tr. 532, L. 10-Tr. 533, L. 16; and, Tr. 534, L. 7-Tr. 535, L.1.

1 C. The Evidentiary Record Contains Substantial Evidence Supporting Ratemaking
2 Recognition and Recovery of the Salaries of NDEs Allocated to SWC for the 2008
3 Test Period.

4 1. *The NDEs Provide Tangible "Value" to the*
5 *Water Utility Operations of SWC*

6 Both SWC's President (Mark Seamans) and Controller (Marian Homiak) provided
7 detailed testimony as to the nature of services provided by NDEs to SWC during the 2008 test
8 period, as well as preceding and subsequent years.⁴⁴ Each had occasion to personally interact
9 with the various NDEs on an ongoing basis, and thus have personal knowledge of the services
10 and work product provided by the NDEs to SWC and its water utility operations. These services
11 included (i) long-range planning, (ii) financial planning and oversight, (iii) capital improvements
12 oversight, (iv) contract negotiation and management, (v) rate case planning, (vi) human
13 resources, (vii) bookkeeping and (viii) clerical services.

14 In that regard, and with specific reference to the test period in this case, Mr. Seamans
15 testified that

16 " . . .the 2008 test year was a significant planning year for the water
17 company. We were looking towards development of the new well.
18 We were looking towards the development of the arsenic treatment
19 facility. We were looking at other major capital planning projects.
20 "45

21 Elsewhere Mr. Seamans' indicated that the NDEs

22 " . . .continue to provide a service that is valuable and important to
23 the water company."⁴⁶

24 Similarly, Ms. Homiak testified that the NDEs provided "actual tangible value" to SWC
25 during 2008, 2009 and 2010 to date.⁴⁷ In that regard, as an example, she testified that one NDE
26 (Michael Bowman) brought to SWC an engineering expertise of 25 years in the water utility
27 industry, which proved to be of great assistance in enabling SWC to control construction costs;⁴⁸

28 ⁴⁴ Generally, see Tr. 255, L. 10-Tr. 264, L. 5 (Seamans); and, Tr. 333, l. 5-Tr. 344, l. 14 (Homiak).

⁴⁵ Tr. 259, L. 14-19.

⁴⁶ Tr. 263, L. 22-Tr. 264, L. 5.

⁴⁷ Tr. 347, L. 15-Tr. 348, L. 1; and, Tr. 356, L. 21-Tr. 357, L. 13.

⁴⁸ Tr. 339, L. 11-Tr. 341, L. 6.

1 and, a second NDE (Cort Chalfont) was “very involved” in overseeing the day-to-day water
2 utility operations of SWC in his capacity as President of the Company during the first six (6)
3 months of 2008.⁴⁹ Based upon her own personal experience and observations with respect to the
4 NDEs, Ms. Homiak identified at least three (3) attributes or measures of value that she believes
5 the NDEs bring to the water utility operations of SWC: (i) efficiency; (ii) quality of service; and
6 (iii) expertise in the water utility industry.⁵⁰ As a consequence, it was “definitely” her opinion
7 that NDEs bring real value to the operations of SWC.⁵¹ In fact, as she noted while being cross-
8 examined by the Commission’s Staff, SWC

9
10 “. . . is a very well-run water company, very well managed, and
11 does it very cost effectively. . . that is the value of the management
12 company [NDEs]. . .”⁵² [emphasis added]

12 2. *The NDE Salaries Allocated to SWC During the*
13 *2008 Test Period Are Reasonable and Appropriate.*

14 During cross-examination, Commission Staff witness Michlik acknowledged that the
15 NDEs had in fact provided “value” to SWC during the calendar 2008 test period.⁵³ Despite this
16 acknowledgement, the Commission Staff appears to believe that there should be no ratemaking
17 recognition and recovery accorded to the allocated salaries of those NDEs whose services
18 provided such “value,” because there are no time sheets detailing the hours spent providing such
19 services, and the specific nature of the same. In that regard, Ms. Homiak acknowledged during
20 her testimony that in retrospect SWC realizes that “it made a mistake of not keeping time
21 sheets”; and, she explained that the instant proceeding “was our first rate case” since SWC
22 received its original certificate of convenience and necessity, and the Company did not foresee
23 that the absence of time sheets for the NDEs would become an issue.⁵⁴

24
25
26 ⁴⁹ Tr. 336, L. 19-23.

27 ⁵⁰ Tr. 385, L. 1-14.

28 ⁵¹ Tr. 385, L. 15-Tr. 386, L. 6.

⁵² Tr. 363, L. 1-4.

⁵³ Tr. 536, L. 12-Tr. 537, L. 4; and, Tr. 537, L. 12-14.

⁵⁴ Tr. 357, L. 14-17.

1 **the Water Company did not seek competitive bids for its**
2 **staffing arrangement.**

3 A.16 Attached to this testimony as Appendix "B" are (i) the
4 results of 2009 Water Utility Compensation Survey conducted by
5 the American Water Works Association ("AWWA") and (ii)
6 national average salaries adjusted by location from the New York
7 Times website. We have included both surveys because the
8 AWWA survey is industry-specific but does not address regional
9 differences. The New York Times salaries are not industry-specific
10 but they represent the median compensation for specific jobs in
11 Tucson, Arizona. Attached to this testimony as Appendix "C" is a
12 comparison of the compensation of Management Company
13 staffing used by the Water Company on a full-time and a part-time
14 basis during 2008 compared to the AWWA survey and/or national
15 average salaries adjusted by location from the New York Times
16 website. As you will note, the compensation paid by the
17 Management Company to such employees is quite comparable to
18 and in-line with the prevailing industry compensation standards
19 reflected in the AWWA and New York Times surveys for
20 comparable positions.

21 Attached to this testimony as Appendix "D" is a
22 comparison of the Water Company's total operating costs to other
23 water companies in Arizona for the test year. This chart indicates
24 that out of 25 companies surveyed, the Water Company is 9th when
25 comparing total expenses per customer, which shows that the
26 Water Company's operating costs are very reasonable.

27 Against this background, I do not believe it can correctly be
28 asserted that the Water Company's ratepayers have been
29 "disadvantaged" by the staffing and services arrangement between
30 the Water Company and the Management Company."⁵⁸ [emphasis
31 added]

32 In his prepared Surrebuttal Testimony, Commission Staff witness Michlik argued that
33 "salary surveys [are] an unreliable basis for comparison"; and, he criticized SWC for not having
34 used competitive bids to obtain the various services provided by the NDEs.⁵⁹ However, Mr.
35 Michlik offered no evidence to indicate that the wide array of services and competence provided
36 to SWC under the Agreement would in fact have been available at all to SWC from a single
37 entity under a competitive bid procedure. Rather, he simply opined that

38 ⁵⁸ See Exhibit A-14 at page 7, L. 14-page 8, L. 14.

39 ⁵⁹ See Exhibit S-9 at page 7, L. 24-page 8, L. 15.

1 “Conventional wisdom and data indicate that competition in the
2 bidding process brings about a price advantage to rate payers that a
3 salary survey does not”.⁶⁰

4 Whereas, Ms. Homiak expressly observed that the range of services and expertise provided
5 through the NDE arrangement with RSMC probably could not have been provided to SWC
6 through individual consulting contracts with various firms possessing the necessary discipline
7 and skills at an equivalent or lesser cost.⁶¹

8 As a final note, absent the use of a competitive bid process or salary survey information
9 which it deems to be “reliable,” the Commission’s Staff appears to propose that there be no
10 ratemaking recognition or recovery at all for any of the NDE salaries allocated to SWC for the
11 2008 test period,⁶² despite the fact that Commission Staff witness Michlik acknowledged during
12 cross-examination that the NDEs provided “value” to SWC during the test period in connection
13 with its water utility operations.⁶³ SWC respectfully submits that the Commission Staff’s
14 position in that regard is contrary to law, and ill-advised as a matter of logic.

15 **D. Summary**

16 For the reasons discussed in Section V(A) through (C) above, SWC submits that (i) the
17 evidentiary record in the instant proceeding contains substantial evidence supporting ratemaking
18 recognition and recovery of the salaries of NDEs allocated to SWC for the 2008 test period; and,
19 (ii) the aggregate allocated NDE salary amount of \$100,831 proposed by SWC should be
20 accepted for such purpose.

21 **VI.**

22 **THE COMMISSION SHOULD ADOPT SWC’S PROPOSED THREE (3)
23 YEAR AMORTIZATION OF SWC’S RATE CASE EXPENSE**

24 This issue is also well summarized in the following excerpt from the prepared Rebuttal
25 Testimony of SWC witness Bourassa:

26 “At this stage of the proceeding, Staff and the Company agree
27 on the total amount of proposed rate case expense of

28 ⁶⁰ See Exhibit S-9 at page 7, L. 25-26.

⁶¹ Tr. 345, L. 21-Tr. 347, L. 13.

⁶² See Exhibit S-9 at page 14, L. 1-3.

⁶³ Tr. 536, L. 12-Tr. 537, L. 4; and, Tr. 537, L. 12-24.

1 \$225,000. However, Staff proposes to normalize rate case
2 expense over 5 years for an annual amount of \$45,000 while
3 the Company proposes to amortize rate case expense over 3
4 years for an annual amount of \$75,000. Not only is there
5 disagreement of the time period, but whether rate case
6 expense should be normalized or amortized.

7 With respect to the time period, while the Company has not
8 been in for a rate case in 14 years, the Company expects to
9 file rate case more often than every 5 years. Thus, Staff
10 assumption and proposed 5 year period is not appropriate.

11 With respect to normalization and amortization, the
12 distinction may not seem important but it has significant
13 implications. Under normalization, if the Company filed
14 another rate case within 5 years and the Company had not
15 recovered the entire \$225,000 of rate case expense, it is lost
16 forever, under amortization, the Company would be able to
17 seek recovery of any unamortized portion in the new rate
18 case. The amortization approach was used by Staff and
19 adopted by this Commission for many years and it has only
20 been the last few years where Staff has proposed the
21 normalization approach.”⁶⁴

22 During the evidentiary hearing on July 20, 2010 SWC witness Seamans provided
23 testimony as to the type(s) and estimated cost(s) of capital improvements it is anticipated that
24 SWC will be undertaking during the next year or two; and, he described operating expenses that
25 the Company has already incurred or will be incurring, which are not reflected in the 2008 test
26 period data.⁶⁵ In addition, he testified that SWC currently anticipates it will be filing its next rate
27 increase application within three (3) years.⁶⁶ The Commission’s Staff did not contest any of the
28 projected capital improvements and operating expense information provided by Mr. Seamans.
Nor, did it challenge his projection of a new rate increase application within the next three (3)
years, other than to note that a longer period of time had elapsed between when SWC’s existing
rates were set and the instant proceeding.⁶⁷

⁶⁴ See Exhibit A-6 at Page 15, L. 17-Page 16, L. 11

⁶⁵ Tr. 265, L. 4-Tr. 274, L. 5.

⁶⁶ Id.

⁶⁷ See Exhibit S-7 at Page 23, L. 2-4.

1 by the Commission in setting rates for numerous water and
 2 wastewater utilities. The return produced by those models was then
 3 adjusted downward by 70 basis points to account for the absence
 4 of debt in the Company's capital structure, and then, finally,
 5 upward by 50 basis points to account for the Company's extremely
 6 small size, lack of investment liquidity, and the additional risk that
 7 results from the particular rate-making methods employed in
 8 Arizona. The table below summarizes the Company's final
 9 position:

Method	<u>Low</u>	<u>High</u>	<u>Midpoint</u>
Range DCF Constant Growth Estimates	9.1%	10.5%	9.8%
Range of CAPM Estimates	<u>10.4%</u>	<u>14.6%</u>	<u>12.5%</u>
Average of DCF and CAPM Midpoint estimates	<u>9.8%</u>	<u>12.6%</u>	<u>11.2%</u>
Financial Risk Adjustment	-0.7%	-0.7%	-0.7%
Specific Company Risk Premium	<u>0.5%</u>	<u>0.5%</u>	<u>0.5%</u>
Indicated Cost of Equity	9.6%	12.4%	11.0%
Recommended Cost of Equity			10.9%

10 The schedules containing the cost of capital analysis are attached
 11 to my cost of capital rejoinder testimony. There have been no
 12 significant changes in the financial markets that affect that
 13 analysis, which was performed approximately seven weeks ago."⁶⁸

14 "The Company's recommended capital structure consists of 18
 15 percent debt and 82 percent common equity as shown on Rejoinder
 16 Schedule D-1. Based on my updated cost of capital analysis, I am
 17 recommending a cost of equity of 10.9 percent. Based on my 10.9
 18 percent recommended cost of equity and 4.2 percent cost of debt,
 19 the Company's weighted cost of capital ("WACC") is 9.69
 20 percent, as shown on Rejoinder Schedule D-1."⁶⁹

21 ⁶⁸ See Exhibit A-7 at Page 2, L. 2-Page 3, L. 2.

22 ⁶⁹ See Exhibit A-7 at Page 3, L. 7-12.

2. *Commission Staff's Position*

“Staff is recommending a capital structure consisting of 17.8 percent debt and 81.2 percent equity. Staff determined a cost of equity of 10.3 percent based on the average cost of equity produced by its DCF and CAPM models. Staff also determined the cost of debt to be 4.2 percent. Based on its 17.8 percent debt and 81.2 percent equity capital structure, Staff determined the WACC for SWC to be 9.2 percent”⁷⁰

C. Relevant Substantive Factors the Commission's Staff Has Either Failed to Consider or Failed to Accord to Appropriate Weight

As noted in Section VII(A) above, SWC believes that Commission Staff witness Juan C. Manrique either failed to consider or accord appropriate weight to several substantive factors which should be taken into account in connection with a determination of SWC's cost of equity and cost of capital for purposes of the instant proceeding. These failures were described by Mr. Bourassa as follows:

“The most Significant problems with Staff's recommendations are, in summary:

(1) Staff ignores the fact that SWC is riskier than the publicly traded utilities in the sample group, despite SWC's small size, lack of liquidity and Arizona's unfavorable regulatory climate. Empirical financial data demonstrate that there exists a relationship between firm size and return. No rational investor would agree with Staff's position, which violates the comparable earnings standard.

(2) Staff improperly double-counts historic growth rates in estimating the future dividend growth rate - g - in the DCF model, and fails to properly utilize the best estimate of expected dividend growth, analysts' forecasts. Historic growth is already reflected in the current stock prices of the publicly traded sample utilities and is considered by analysts in developing their growth rate forecasts. This error depresses the result produced by the DCF model.

(3) Staff determines an after-tax rate of return based upon publicly traded water utilities but Staff is recommending the disallowance of income taxes in the revenue requirement for SWC. The comparison to the publicly traded water utilities is only meaningful when SWC's earnings are determined on an after-tax basis. In fact, when incomes taxes are disallowed the cash flows available [for] dividends are significantly reduced and the value of an investment in SWC is significantly diminished.

⁷⁰ See Exhibit A-7 at Page 3, L. 17-22. Also see Exhibit S-6 at Page 2, L. 1-18.

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

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(4) Based on the Staff recommendations in the instant case (exclusion of Well #23 plant costs from rate base and a 9.2 percent rate of return), the Company will have insufficient earnings from which to pay dividends (distributions) at a level comparable to the publicly traded utilities. Moreover, the insufficiency of earnings is compounded by Staff[’s] recommendation to disallow income taxes. As a result, Staffs recommendations fail to meet the standards set forth in *Hope* and *Bluefield* and must be rejected.”⁷¹ [emphasis in original]

While the first and second factors discussed above are subject to being characterized as a “difference of opinion” between Mr. Bourassa and Mr. Manrique, the third and fourth factors are not. Rather, they involved tangible considerations which directly impact the adequacy of earnings available to SWC if the Commission Staff’s recommended 9.2 percent cost of capital is adopted, together with the Commission Staff’s recommendations relating to non-recognition of income taxes as an operating expense and the exclusion of Well #23 from rate base. Accordingly, the collective impact of these three (3) Commission Staff recommendations cannot and should not be ignored by the Commission.⁷²

D. Commission Adoption of Commission Staff’s Cost of Capital, Income Tax and Well #23 Recommendations Would Deny to SWC the Ability to Adequately Financially Service that Capital Already Committed to the Provision of Water Utility Service to SWC’s Customers.

Schedule D-1 to Mr. Bourassa’s prepared Rejoinder Testimony indicates that as of the end of the 2008 test period SWC had \$15,631,081 of capital committed to the provision of ongoing water utility service to SWC’s customers. \$2,816,714 of this capital commitment is represented by long-term debt, and \$12,814,367 of such committed capital is represented by investor equity. Pursuant to the legal criteria established in the Hope and Bluefield decisions, SWC must be granted revenues adequate to allow the Company to recover its costs of operations and to service its committed capital at a level of return sufficient to enable SWC to attract future capital. However, Commission adoption of Commission Staff’s cost of capital, income tax and

⁷¹ See Exhibit A-7 at Page 4, L. 1-Page 5, L. 4.

⁷² See Exhibit A-7 at Page 5, L. 20-Page 10, L. 8 for a detailed illustration of how these three (3) Commission Staff recommendations would adversely impact SWC to the substantial financial detriment of the Company and its investors.

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 Well #23 recommendations would deny to SWC the ability to adequately service that capital
2 already committed to the provision of water utility service to SWC's customers.

3 The following excerpts from Mr. Bourassa's prepared Rejoinder Testimony specifically
4 explain this circumstance:

5 **"Q15. ISN'T THE PROBLEM OF SUFFICIENCY OF**
6 **EARNINGS A FUNCTION OF THE AMOUNT OF RATE**
7 **BASE THAT STAFF IS PROPOSING AND THE AMOUNT**
8 **INVESTED CAPITAL IN THE CAPITAL STRUCTURE?**

9 A15 Yes. Staff's rate base is approximately \$8.71 million while
10 total capital in the capital structure is over \$15.6 million. The
11 inequality between Staff's rate base and invested capital in the
12 instant case is partly the result of Staff's proposed disallowance of
13 approximately \$1.8 million of plant (Well #23) in rate base. But,
14 whatever the reason for the inequality between rate base and
15 capital, investor supplied capital always has an earnings
16 requirement (interest, dividends, and earnings). As stated by Dr,
17 Morin,

18 The totality of a company's capital has to be
19 serviced, whether through the medium of operating
20 revenues or in part the accrual of AFUDC.
21 Therefore, the allowed rate of return on common
22 equity is applicable to the total common equity
23 component of the total investments of the utility
24 company. Anything less than that has the direct and
25 immediate effect of reducing common equity return
26 below the level needed to meet the capital attraction
27 and comparable earnings standards articulated in the
28 *Hope* and *Bluefield* decisions. To apply an allowed
rate of return to a rate base that does not provide for
total common equity investments does not maintain
the integrity of that capital and does not enable the
company to attract capital.

29 **Q16. THE COMPANY PROPOSED RATE BASE IS LESS**
30 **THAN INVESTED CAPITAL. WILL THE COMPANY**
31 **HAVE SUFFICIENT EARNINGS FROM WHICH TO PAY**
32 **DIVIDENDS (DISTRIBUTIONS)?**

33 A16. Yes. The Company is recommending a rate base of
34 approximately \$10.1 million. However, the earnings available to
35 pay the \$715,000 dividends will be about \$857,000. Let me
36 explain. The Company proposed operating income (after-tax) is
37 about [\$]975,000. As discussed above, interest expense will be
38 \$118,000, so the earnings available for dividends will be about

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ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 \$857,000 (\$975,000 minus \$118,000). After paying dividends of
2 \$715,000 the earnings retained by the Company will be \$141,458.
3 The payout ratio will be a bit higher than the publicly traded water
4 utilities at about 83.5 percent (\$715,000 divided by \$857,000), but
5 retained earnings are positive. The Company will still able to
6 service the totality of its capital despite the inequality between its
7 proposed rate base and total invested capital.⁷³ [emphasis added]
8 and ⁷⁴

6 **E. Summary.**

7 For the reasons discussed in Section VII(B) through (D) above, SWC submits that the
8 evidentiary record in the instant proceeding warrants a determination that SWC's cost of equity
9 is 10.9 percent and its weighted cost of capital is 9.69 percent. A lesser determination by the
10 Commission would not provide SWC with revenues sufficient to satisfy the capital attraction
11 requirements of the Hope and Bluefield decisions, even assuming a Commission decision (i)
12 including Well #23 in rate base, and (ii) recognizing and recovering income taxes as an operating
13 expense.

14 **VIII.**

15 **THE COMMISSION SHOULD ADOPT THE CENTRAL ARIZONA**
16 **GROUNDWATER REPLENISHMENT DISTRICT ("CAGRD") FEE ADJUSTOR**
17 **PROPOSED BY SWC, TOGETHER WITH THE COMPLIANCE**
18 **CONDITIONS PROPOSED BY THE COMMISSION'S STAFF, AS MODIFIED**
19 **IN THE MANNER REFLECTED IN APPENDIX "E" HERETO**

20 SWC and the Commission's Staff appear to be in agreement as to the conceptual
21 appropriateness of the CAGRD Fee Adjustor proposed by SWC.⁷⁵ However, the Commission
22 Staff's support was contingent upon Commission adoption of nine (9) compliance conditions
23 proposed by the Commission's Staff.⁷⁶ SWC initially had some concerns with regard to the
24 intent or language of certain of these compliance conditions; and, SWC's concerns were
25 discussed by SWC witness Seamans in his prepared Rebuttal Testimony and his prepared

26 ⁷³ See Exhibit A-7 at Page 8, L. 24-Page 10, L. 8.

27 ⁷⁴ In that regard, it should be noted that the proposed operating income (after tax) of \$975,000 upon which Mr.
28 Bourassa's conclusion is based assumes (i) inclusion of Well #23 in rate base, and (ii) ratemaking recognition and
recovery of income taxes as an operating expense.

⁷⁵ See Exhibit S-7 at Page 25, L. 11-Page 26, L. 32.

⁷⁶ See Exhibit S-7 at Page 26, L. 32-Page 28, L. 12.

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 Rejoinder Testimony,⁷⁷ and during the July 20, 2010 evidentiary hearing in the instant
2 proceeding.⁷⁸ By the end of the evidentiary hearing, a number of SWC's previous concerns had
3 been satisfactorily addressed, and those remaining had been articulated by Mr. Seamans.

4 In connection with the above, the Administrative Law Judge ("ALJ") assigned to the
5 instant proceeding suggested that counsel for SWC and the Commission's Staff explore prior to
6 filing their respective post-hearing briefs the possibility of modifying the CAGR D Adjustor Fee
7 compliance conditions originally proposed by the Commission's Staff, so as to (i) address certain
8 questions raised by the ALJ during the evidentiary hearing, and (ii) reach agreement as to
9 language for such compliance conditions mutually acceptable to the Commission's Staff and
10 SWC.⁷⁹

11 Attached to this Post-Hearing Initial Brief as Appendix "E" is a copy of the Commission
12 Staff's original nine (9) CAGR D Fee Adjustor compliance conditions, as modified with redlining
13 and strikethrough to reflect language additions and deletions which adequately address SWC's
14 previous concerns from SWC's perspective. Accordingly, SWC supports Commission adoption
15 of all nine (9) compliance conditions as so modified.⁸⁰

23 ⁷⁷ See Exhibit A-1 at Page 1, L. 9-Page 4, L. 16; and Exhibit A-11 at Page 1, L. 9-20, and Page 1, L. 26-Page 5, L. 7.

24 ⁷⁸ Tr. 287, L. 4-Tr. 305, L. 22.

24 ⁷⁹ Tr. 303, L. 13-Tr. 305, L. 3.

25 ⁸⁰ Counsel for SWC and the Commission's Staff did communicate on several occasions subsequent to the
26 evidentiary hearings for the purpose of exploring language which would be acceptable to both SWC and the
27 Commission's Staff. Based upon such post-hearing communications, it is SWC's understanding that the modified
28 language proposed by SWC for Conditions Nos. 1 through 7 and 9, as reflected in Appendix "E" hereto is
acceptable to the Commission's Staff. It is further SWC's understanding that the Commission Staff intends to
propose Commission Staff's own language for Condition No. 8; and, SWC will respond to that language in SWC's
Post-Hearing Reply Brief. In that regard, SWC's concerns with respect to Commission Staff's original language for
Condition No. 8 were described by Mr. Seamans during the July 20, 2010 evidentiary hearing. See Tr. 300, L. 3-Tr.
305, L. 3; and, Tr. 321, L. 21-Tr. 322, L. 11.

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 IX.
2 SWC'S SUBMITTAL OF PROPOSED TARIFFS REFLECTING
3 SWC'S SELECTION OF VARIOUS ARIZONA DEPARTMENT OF WATER
4 RESOURCES ("ADWR") BEST MANAGEMENT PRACTICES ("BMP")
5 CONSTITUTES COMPLIANCE WITH DECISION NO. 70620, AND SWC
6 SUPPORTS THE COMMISSION STAFF'S RECOMMENDATIONS
7 WITH RESPECT TO SUCH PROPOSED TARIFFS

8 As Commission Staff witness Marlin Scott, Jr. noted in the Engineering Report attached
9 to his prepared Direct Testimony, SWC was required by Decision No. 70620 to file 11 ADWR
10 BMPs selected by SWC with the Commission by December 31, 2009.⁸¹ Thereafter, in his
11 prepared Surrebuttal Testimony, Mr. Scott indicated that the Commission's Staff and SWC had
12 agreed to revised formatting and certain language for the BMPs previously filed by SWC; and,
13 he stated that

14 ". . . After the final review process, Staff is recommending
15 approval of the BMPs with the exception of BMP 7.8. This BMP
16 shall only become effective if and when it is approved by ADWR.
17 If BMP 7.8 is not approved by ADWR by July 1, 2011, the
Company shall submit a replacement BMP for Commission
Consideration. Copies of the final version of these BMPs are
attached."⁸²

18 Thereafter, in his prepared Rejoinder Testimony, SWC witness Seamans testified as follows on
19 this subject:

20 "As indicated in Mr. Scott's Surrebuttal Testimony, the Staff is
21 recommending approval of all of the Company's proposed ADWR
22 BMP Tariffs but the one relating to BMP 7.8. With respect to BMP
23 7.8, the Staff is recommending no final action by the Commission
24 until ADWR has reviewed and approved the proposed tariff.

25 **Q.9 Is the approach suggested by the Staff with respect to
26 BMP 7.8 acceptable to the Company?**

27 A. 9 Yes, with the understanding that the Company's activities to
28 date regarding all of the BMPs it has selected and reduced to
proposed forms of tariff constitute compliance with the applicable
provisions of Decision No. 70620."⁸³

⁸¹ See Exhibit MSJ (to Exhibit S-1) at Page 12 of 40.

⁸² See Exhibit S-2 at Page 5, L. 18-23.

⁸³ See Exhibit A-11 at Page 5, L. 19-Page 6, L. 3.

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 Finally, during the July 20, 2010 evidentiary hearing in the instant proceeding, Mr. Scott testified
2 that he believed SWC was in compliance with that portion of Decision No. 70620 which required
3 that SWC select and submit 11 BMPs to the Commission.⁸⁴

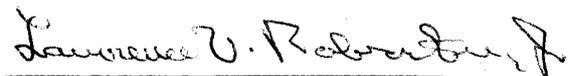
4 Given the above, it would appear that there is not an issue between SWC and the
5 Commission's Staff with respect to either (i) SWC's compliance with the relevant provisions of
6 Decision No. 70620, or (ii) the BMPs that SWC has selected to implement. The only question
7 pertains to whether ADWR will approve SWC's proposed pilot program for implementing BMP
8 7.8; and, as an exchange between Mr. Scott and the ALJ during the evidentiary hearing indicates,
9 as of this juncture no one knows how ADWR is going to respond.⁸⁵

10 Accordingly, SWC recommends that the Opinion and Order to be issued in the instant
11 proceeding (i) find that SWC has complied with the applicable provisions of Decision No.
12 70620, and (ii) approve the Commission Staff's recommendations with regard to SWC's
13 proposed BMP tariffs.

14 **X.**
15 **CONCLUSION**

16 SWC will not endeavor in this section to summarize all of the dispositive actions by the
17 Commission which SWC has requested as to the issues presented and discussed in Sections I
18 through IX above of this Post-Hearing Initial Brief. Rather, SWC will incorporate those requests
19 and the related discussion herein by this reference in the interest of brevity.

20
21 Dated this 14th day of September 2010.

22 

23 Lawrence V. Robertson, Jr.
24 P. O. Box 1448
25 Tubac, Arizona 85646
26 Attorney for Sahuarita Water Company, L.L.C.

27
28 ⁸⁴ Tr. 419, L. 11-14.

⁸⁵ Tr. 419, L. 15-Tr. 421, L. 2.

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

1 The original and thirteen (13) copies of the
2 above Post-Hearing Initial Brief will be filed
3 the 15th day of September 2010 with:

3 Docket Control
4 Arizona Corporation Commission
5 C/O 400 West Congress, Suite 218
6 Tucson, Arizona 85701

6 A copy of the above Post-Hearing Initial Brief
7 will be emailed that same date to:

8 Jane L. Rodda, Administrative Law Judge
9 Hearing Division
10 Arizona Corporation Commission
11 400 West Congress, Suite 218
12 Tucson, Arizona 85701

11 Janice M. Alward, Chief Counsel
12 Legal Division
13 Arizona Corporation Commission
14 1200 West Washington Street
15 Phoenix, Arizona 85007

14 Wesley Van Cleve
15 Legal Division
16 Arizona Corporation Commission
17 1200 West Washington Street
18 Phoenix, Arizona 85007

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Appendix “A”

**Sahuarita Water Company
Post-Hearing Initial Brief
September 15, 2010
Docket No. W-03718-09-0359**

Recommended Standards for Water Works

2007 Edition

Policies for the Review and Approval of Plans and Specifications for Public Water Supplies

A Report of the Water Supply Committee of the
Great Lakes--Upper Mississippi River Board
of State and Provincial Public Health and Environmental Managers

MEMBER STATES AND PROVINCE
Illinois Indiana Iowa Michigan Minnesota Missouri
New York Ohio Ontario Pennsylvania Wisconsin

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Public Health and Environmental Managers

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3.2 GROUNDWATER

A groundwater source includes all water obtained from dug, drilled, bored or driven wells, and infiltration lines.

3.2.1 Quantity

3.2.1.1 Source capacity

The total developed groundwater source capacity, unless otherwise specified by the reviewing authority, shall equal or exceed the design maximum day demand with the largest producing well out of service.

3.2.1.2 Number of sources

A minimum of two sources of groundwater shall be provided, unless otherwise specified by the reviewing authority. Consideration should be given to locating redundant sources in different aquifers or different locations of an aquifer.

3.2.1.3 Standby power

- a. To ensure continuous service when the primary power has been interrupted, a standby power supply shall be provided through
 1. connection to at least two independent public power sources, or
 2. dedicated portable or in-place auxiliary power of adequate supply and connectivity.
- b. When automatic pre-lubrication of pump bearings is necessary, and an auxiliary power supply is provided, the pre-lubrication line shall be provided with a valved by-pass around the automatic control, or the automatic control shall be wired to the emergency power source.

Appendix “B”

**Sahuarita Water Company
Post-Hearing Initial Brief
September 15, 2010
Docket No. W-03718-09-0359**

**SAHUARITA
WATER COMPANY, LLC**

**WATER SYSTEM
MASTER PLAN**

Prepared for:

SAHUARITA WATER COMPANY
15900 Rancho Resort Blvd, Bldg No. 3
Sahuarita, Arizona 85629
(520) 399-1105

Prepared by:

WESTLAND RESOURCES, INC.
4001 E. Paradise Falls Drive
Tucson, Arizona 85712
(520) 206-9585



NOVEMBER 2007
Project No. 217.132 A 8000

CHAPTER 3. ENGINEERING CRITERIA

Based on the information presented in Chapter 2, the system design criteria for the Master Plan are described below in terms of demand, supply, storage, and distribution system assumptions. The criteria presented in this chapter follow ADEQ, Arizona Department of Water Resources (ADWR), and Arizona Administrative Code (AAC) standards.

3.1. DEMAND CRITERIA

- Average daily per capita water usage for Single-Family and Active Adult residential 110 gpcd
- Average daily per capita water usage for Multi-Family residential 90 gpcd
- Average daily per square foot commercial, industrial,
Institutional water use (gallons per day per square foot)..... 0.12*
- Average daily water usage for elementary/middle school use 25 gallons per student per day (gpsd)
- Average daily water usage for high school use 43 gpsd
- Average number of persons per Single-Family dwelling unit 2.7
- Average number of persons per Active Adult dwelling unit 1.8
- Average number of persons per Multi-Family dwelling unit 1.9
- Ratio of peak-day to average-day use 2.0
- Ratio of peak-hour to average-day use 3.2

*Based on Arizona Administrative Code Title 18, Chapter 9, Shopping Center no food or laundry, sewage assumed to be 85 percent of water usage.

gpcd – gallons per capita per day
gpac – gallons per acre per day

3.2. SUPPLY CRITERIA

- Well capacity to meet PDD with the largest well out of service.
- Minimum supply from well and boosters pumping to elevated storage to meet PDD.
- Minimum booster capacity to zones without elevated storage to meet peak hour demand (PHD) or PDD plus fire flow, whichever is larger.

3.3. STORAGE CRITERIA

- Provide storage volume equal to a minimum of 1.0 times the ADD.
- Provide additional storage volume required to provide fire flow for a specific duration to each zone (see Tables 8 and 14)
- Provide valving at reservoirs to allow a change in the direction of supply to lower zones if required for fire flow.
- Provide two equally sized reservoirs at critical sites for phasing and maintenance considerations.

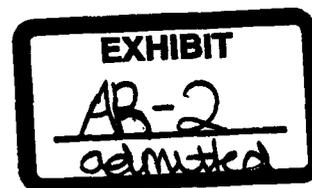
Appendix “C”

**Sahuarita Water Company
Post-Hearing Initial Brief
September 15, 2010
Docket No. W-03718-09-0359**

Las Quintas Serenas Water Company

Docket Nos. W-01583A-04-0178, W-01583A-05-0326 and

W-01583A-05-0340



**Applicant's
Exhibit AR-2**

February 16, 2006

Mr. Steve Gay, Operation/Manager
LAS QUINTAS WATER COMPANY
P.O. Box 68
Sahuarita, Arizona 85629

Re: WATER SYSTEM STORAGE REQUIREMENTS

Dear Steve:

This is in response to your request to clarify the rules and regulations pertaining to water system storage requirements for public water systems.

Pima County Department of Environmental Quality's policy is to approve plans and designs, which adhere to the minimum standards and guidelines found in Arizona Administrative Code, Title 18, Chapter 5 and ADEQ's Engineering Bulletin #10. Neither of these codes and bulletins have been significantly revised in the past 14 years, while historical documentation and examples on what works and what doesn't continues to grow showing a need for these codes and bulletins to be significantly revised.

The rest of this letter is a personal recommendation, which is based on 13 years of experience working for Pima County Department of Environmental Quality, and with over 200 Public Water Systems within Pima County.

Per the Arizona Revised Statutes R18-5-503 Storage Requirements, ... "the minimum storage capacity shall be equal to the average daily demand during the peak month of the year." This is the minimum storage capacity typically required for public water systems in order to provide adequate above ground storage. This storage is required to provide peak capacity during the peak hour demands through the summer months, and also emergency storage when a large well is out of service. In addition to this minimum storage capacity requirement, all fire flow requirements needs to be in addition to this volume. The Arizona Administrative Code also includes a caveat that states the following; "The minimum storage capacity for a multiple well system may be reduced by the amount of the total daily demand minus the production from the largest producing well." While this option may allow the water company to reduce the minimum storage capacity required for water systems, typically using this equation produces a negative net requirement of storage capacity and from my personal experience this only works with very small water system with populations under a few hundred. While it is the option of the water company to choose this methodology for determining storage, it is my strong recommendation that the minimum storage capacity for a water system be equal to or greater than the average daily demands during the peak month of the year for all water systems. This volume of above-ground storage provides adequate capacity to serve a water system during peak hour demands, throughout the peak demands of the summer months, and also provides emergency storage for well outages. I believe this will better provide a water system with greater reliability, public safety, and provide the greatest level of service to the customers.

Sincerely,



Mike Redmond, R.S.
Sr. Civil Engineering Assistant

cc: Mike Wood, Director, LQS Board Director
Rohn Hourseholder, LQS Board Director
John S. Gay, Director, LQS Board Director

Appendix “D”

**Sahuarita Water Company
Post-Hearing Initial Brief
September 15, 2010
Docket No. W-03718-09-0359**



Limited Liability Company (LLC)

A Limited Liability Company (LLC) is a business structure allowed by state statute. LLCs are popular because, similar to a corporation, owners have limited personal liability for the debts and actions of the LLC. Other features of LLCs are more like a partnership, providing management flexibility and the benefit of pass-through taxation.

Owners of an LLC are called members. Since most states do not restrict ownership, members may include individuals, corporations, other LLCs and foreign entities. There is no maximum number of members. Most states also permit "single member" LLCs, those having only one owner.

A few types of businesses generally cannot be LLCs, such as banks and insurance companies. Check your state's requirements and the federal tax regulations for further information. There are special rules for foreign LLCs.

Classifications

The federal government does not recognize an LLC as a classification for federal tax purposes. An LLC business entity must file as a corporation, partnership or sole proprietorship tax return.

An LLC that is not automatically classified as a corporation can file Form 8832 to elect their business entity classification. A business with at least 2 members can choose to be classified as an association taxable as a corporation or a partnership, and a business entity with a single member can choose to be classified as either an association taxable as a corporation or disregarded as an entity separate from its owner, a "disregarded entity." Form 8832 is also filed to change the LLC's classification.

Effective Date of Election

The election to be taxed as the new entity will be in effect on the date the LLC enters on line 8 of Form 8832. However, if the LLC does not enter a date, the election will be in effect as of the form's filing date. The election cannot take place more than 75 days prior to the date that the LLC files Form 8832 and the LLC cannot make the election effective for a date that is more than 12 months after it files Form 8832. However, if the election is the "initial classification election," and not a request to change the entity classification, there is relief available for a late election (more than 75 days before the filing of the Form 8832).

References/Related Topics

- [Forming a Limited Liability Company](#)
- [Single Member Limited Liability Companies](#)
- [LLC Filing as a Corporation or Partnership](#)
- [Possible Repercussions](#)
- [Forms for Limited Liability Companies](#)
- [Form 8832](#)

[Rate the Small Business and Self-Employed Web Site](#)

Page Last Reviewed or Updated: August 27, 2009

Appendix “E”

**Sahuarita Water Company
Post-Hearing Initial Brief
September 15, 2010
Docket No. W-03718-09-0359**

1. The adjustor fee shall apply to all water sold after October 1, 2010, or shall become effective on the date new rates from this case become effective, whichever is later.
2. The Company shall, on a monthly basis, place all CAGR D monies collected from customers in a separate, interest-bearing account ("CAGR D Account").
3. The only time the Company can withdraw money from the CAGR D Account is to pay the annual CAGR D fee to the CAGR D, which is due on October 15th of each year.
4. The Company must provide to Staff a semi-annual report of the CAGR D Account and CAGR D use fees collected from customers and paid to the CAGR D, with the reports due during the last week of October and the last week of April of each year.
5. The Company must provide to Staff, every ~~even-numbered year~~, (first year being ~~2010~~) by June 30th, the new firm rates set by the CAGR D for the ~~next two~~ following years.
6. The total CAGR D fees for the most current year in the Pima Tucson Active Management Area (AMA) shall be divided by the gallons sold in that year to determine a CAGR D fee per 1,000 gallons. This information shall be given to Staff, ~~3~~60 days prior to when the Company requests the adjustor to take effect. In

addition, the Company will provide Staff with supporting documentation from the relevant state agencies, and gallons sold data. Failure to provide this information to Staff shall result in the immediate cessation of the CAGR D adjustor fee.

7. By August 25th of each year, beginning in 2011, the Company shall submit its proposed CAGR D adjustor fee for the Pima Tucson AMA for ~~consideration~~ review and approval by the Commission, with the Commission-approved amount becoming effective the following October 1st.

8. If the CAGR D changes its current method of assessing fees, (i.e. based on the current volume of water used by customers) to some other method, such as, but not limited to, future projection of water usage, or total water allocated to the Company, the Company's collection from customers of CAGR D fees shall ~~cease~~ continue under the CAGR D fee adjustor methodology previously approved by the Commission until a revised methodology reflecting such change in CAGR D's assessment methodology is approved by the Commission. In the event such continued collection under the previously authorized methodology during the interim period results in an overcollection or undercollection under the new methodology approved by the Commission, the Company will "true up" such overcollection or undercollection prior to its compliance with Condition No. 7 of the following year.

9. As a compliance item, the Company shall submit yearly, a new tariff reflecting the reset adjustor amount.