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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF BELLA VISTA WATER CO., INC. AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANTS AND PROPERTY AND FOR INCREASES IN ITS WATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO. W-02465A-09-0411
IN THE MATTER OF THE APPLICATION OF NORTHERN SUNRISE WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANTS AND PROPERTY AND FOR INCREASES IN ITS WATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO. W-20453A-09-0412
IN THE MATTER OF THE APPLICATION OF SOUTHERN SUNRISE WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANTS AND PROPERTY AND FOR INCREASES IN ITS WATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO. W-20454A-09-0413 Arizona Corporation Commission DOCKETED OCT 29 2010 DOCKETED BY

IN THE MATTER OF THE JOINT APPLICATION OF BELLA VISTA WATER CO., INC., NORTHERN SUNRISE WATER COMPANY, INC., AND SOUTHERN SUNRISE WATER COMPANY, INC. FOR APPROVAL OF AUTHORITY TO CONSOLIDATE OPERATIONS, AND FOR THE TRANSFER OF UTILITY ASSETS TO BELLA VISTA WATER CO., INC. PURSUANT TO ARIZONA REVISED STATUTES 40-285.	DOCKET NO. W-02465A-09-0414 DOCKET NO. W-20453A-09-0414 DOCKET NO. W-20454A-09-0414

BELLA VISTA WATER COMPANY
NORTHERN SUNRISE WATER COMPANY
SOUTHERN SUNRISE WATER COMPANY

REPLY CLOSING BRIEF

October 29, 2010

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A PROFESSIONAL CORPORATION
PHOENIX

TABLE OF ABBREVIATIONS AND CONVENTIONS

Applicants use the following abbreviations in citing to the pre-filed testimony and hearing transcripts in this brief. Other documents that were admitted as exhibits during the hearing are cited by hearing exhibit number. The parties' final schedules setting forth their respective final positions will be cited in abbreviated format as follows: Applicants, BVWC, NSWC, or SSWC Final Schedule XXX, Staff Final Schedule XXX; RUCO Final Schedule XXX.* Other citations to testimony and documents are provided in full, including (where applicable) the Corporation Commission's docket number and filing date.

APPLICANTS' PRE-FILED TESTIMONY

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Direct Testimony of Greg Sorensen (09-0411) Bella Vista Water Company	**A-1**	Sorensen BVWC Dt.
Direct Testimony of Greg Sorensen (09-0412) Northern Sunrise Water Company	**A-2**	Sorensen NSWC Dt.
Direct Testimony of Greg Sorensen (09-0413) Southern Sunrise Water Company	**A-3**	Sorensen SSWC Dt.
Direct Testimony of Greg Sorensen (09-0414) Joint Application for Consolidation	**A-4**	Sorensen Joint Dt.
Rebuttal Testimony of Greg Sorensen	**A-5**	Sorensen Rb.
Rejoinder Testimony of Greg Sorensen	**A-6**	Sorensen Rj.
Direct Testimony of Thomas J. Bourassa (09-0411) Bella Vista Water Company	**A-7**	Bourassa BVWC Dt.
Direct Testimony of Thomas J. Bourassa (COC) (09-0411) Bella Vista Water Company	**A-8**	Bourassa BVWC COC Dt.

* Applicants filed their Final Schedules on September 16, 2010.

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Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Direct Testimony of Thomas J. Bourassa (09-0412) Northern Sunrise Water Company	**A-9**	Bourassa NSWC Dt.
Direct Testimony of Thomas J. Bourassa (COC) (09-0412) Northern Sunrise Water Company	**A-10**	Bourassa NSWC COC Dt.
Direct Testimony of Thomas J. Bourassa (09-0413) Southern Sunrise Water Company	**A-11**	Bourassa SSWC Dt.
Direct Testimony of Thomas J. Bourassa (COC) (09-0413) Southern Sunrise Water Company	**A-12**	Bourassa SSWC COC Dt.
Direct Testimony of Thomas J. Bourassa (09-0414) Joint Application for Consolidation	**A-13**	Bourassa Joint Dt.
Rebuttal Testimony of Thomas J. Bourassa	**A-14**	Bourassa Rb.
Rebuttal Testimony of Thomas J. Bourassa (COC)	**A-15**	Bourassa COC Rb.
Rejoinder Testimony of Thomas J. Bourassa	**A-16**	Bourassa Rj.
Rejoinder Testimony of Thomas J. Bourassa (COC)	**A-17**	Bourassa COC Rj.
Rebuttal Testimony of Peter Eichler	**A-18**	Eichler Rb.
Rejoinder Testimony of Peter Eichler	**A-19**	Eichler Rj.

STAFF
PRE-FILED TESTIMONY

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Direct Testimony of Pedro M. Chaves	**S-1**	Chaves Dt.
Surrebuttal Testimony of Pedro M. Chaves	**S-2**	Chaves Dt.
Direct Testimony of Marlin Scott Jr.	**S-3**	Scott Dt.
Surrebuttal Testimony of Marlin Scott Jr.	**S-4**	Scott Sb.
Direct Testimony of Crystal S. Brown	**S-6**	Brown Dt.
Surrebuttal Testimony of Crystal S. Brown	**S-7**	Brown Sb.
Supplemental Direct Testimony of Crystal S. Brown	**S-8**	Brown Supp. Dt.

RESIDENTIAL UTILITY CONSUMER OFFICE
PRE-FILED TESTIMONY

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Direct Testimony of William A. Rigsby	**R-6**	Rigsby Dt.
Supplemental Direct Testimony of William A. Rigsby	**R-7**	Rigsby Supp. Dt.
Surrebuttal Testimony of William A. Rigsby	**R-8**	Rigsby Sb.
Direct Testimony of Rodney L. Moore	**R-9**	Moore Dt.
Supplemental Direct Testimony of Rodney L. Moore	**R-10**	Moore Supp. Dt.
Surrebuttal Testimony of Rodney L. Moore	**R-11**	Moore Sb.
Direct Testimony of Timothy J. Coley	**R-12**	Coley Dt.

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Surrebuttal Testimony of Timothy J. Coley	**R-13**	Coley Sb.
Direct Testimony of Jodi A. Jerich	**R-25**	Jerich Dt.
Supplemental Direct Testimony of Jodi A. Jerich	**R-26**	Jerich Supp. Dt.
Surrebuttal Testimony of Jodi A. Jerich	**R-27**	Jerich Sb.

OTHER PORTIONS OF THE RECORD

	Hearing Exhibit
AZAm - Liberty shared services model comparison	**A-21**
American Water Annual Report	**A-26**
1996 NARUC Misc. Expense for Class A Water Utilities	**A-28**
Global form S-1	**A-29**
Excerpt from Becker AZ AM SB Testimony	**A-30**
Asset Retirement Policy	**A-31**
Travis Materials re: Customer Deposits	**S-25**
NARUC Guidelines for Affiliate Transactions	**R-20**

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Applicants Bella Vista Water Co., Inc. ("BVWC"), Northern Sunrise Water Company, Inc. ("NSWC"), and Southern Sunrise Water Company, Inc. ("SSWC") (jointly "Applicants" or "Company") hereby reply to the closing briefs filed by Staff and RUCO in this consolidation and rate case.[1]

I. STAFF'S BRIEF IS INCONSISTENT WITH ITS FINAL SCHEDULES.

There are several material errors and inconsistencies between Staff's brief and Staff's Final ***"Corrected"*** Schedules dated October 5, 2010.[2] As a result, the numbers in Staff's Brief for rate base, revenue requirement and rate increase do not match Staff's final corrected schedules.[3] Some of the mistakes are ones Staff has admitted to and corrected earlier. A summary of the most critical inconsistencies is as follows:

> ADITS: Staff's ADIT number quoted in the brief does not match Staff's final schedules. In its brief, Staff discusses an ADIT liability of approximately $654,000, but Staff's final schedules show $626,000.[4] Also, Staff is wrong in stating that the Company proposed the same ADIT as Staff.[5] The Company actually proposes an ADIT liability of roughly $572,000 using the methodology all parties agreed to use for this case.[6] After the confusion at trial over Staff's final position on ADITs,[7] the Company has no idea what Staff's position actually is on ADITs.[8]
>
> Inadequately Supported Plant. Staff recommended disallowing roughly $185,000 of plant for inadequate support, after which the Company adopted about $80,000 of the adjustment as related to

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[1] In this reply brief, Applicants use the same citation format, abbreviations and conventions as utilized in its initial closing brief dated October 5, 2010. Additionally, the parties' closing briefs will be identified as "Applicants Br.," "Staff Br.," and "RUCO Br.," respectively.

[2] Staff's Final Schedules to Opening Brief, filed October 5, 2010. The schedules are herein referred to as "Staff Final Corrected Schedule" XXX.

[3] For example, the rate base number in the brief is $7,914,522, but Staff's final corrected schedule shows $7,942,328. Likewise, the revenue requirement in the brief is $4,589,644 whereas Staff's final corrected schedule shows $4,641,716. *Compare* Staff Br. at 3:4-6 *with* Staff Final Corrected Schedule CSB-1 (Consolidated Systems).

[4] Staff Br. at 6:3-4; Staff Final Corrected Schedule CSB-3 (Consolidated Systems).

[5] Staff Br. at 6:3-4.

[6] Tr. at 544:13-18, 617:11-13.

[7] *Id.* at 939:13-25. As mentioned in its brief, the Company had hoped Staff would clear up this confusion in its brief. Applicants Br. at 12:4-9. Instead, Staff has made the confusion worse.

[8] The Company and RUCO remain in agreement on the methodology, and differ only slightly due to different numbers elsewhere in the schedule. *See* RUCO Br. at 6.

> AFUDC. The actual plant Staff's adjustment relates to is approximately $104,000, but Staff continues to assert that $185,000 is in dispute.[9]
>
> Corporate Allocation. With respect to the corporate allocation, Staff asserts that the Company argued for the use of 63 facilities, yet Staff admits a page earlier that the Company used 70 facilities.[10] In fact, the Company agreed to use an allocation number of 70 facilities.[11]
>
> Rate Case Expense. Staff claims that the Company seeks $450,000 of rate case expense.[12] The Company, however, seeks $375,000 of rate case expense.[13] The Company's witness took the stand on the third day of trial and testified that the Company was requesting this amount, a $75,000 reduction from the Company's initial estimate.[14] But this is not the number Staff uses for comparison purposes. Instead, Staff erroneously uses $450,000. Further, Staff compares its mistakenly inflated number to $133,000 for the Global Water rate case expense.[15] This is the same number Staff mistakenly used in its comparative analysis in direct, which Staff then corrected in surrebuttal and on the stand to $400,000.[16]

Put bluntly, these problems have not made this rate case easy or inexpensive. Rather, these inconsistencies have contributed directly to the cost of this case, which makes Staff's (and RUCO's) efforts to reduce that expense unreasonable and inequitable, as discussed below (Section III.B).[17]

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[9] Staff Br. at 4:11-12.

[10] *Compare id.* at 13:12 *with id.* at 12:16.

[11] Eichler Rb. at 24.

[12] Staff Br. at 16:14.

[13] Applicants Final Schedule C-2, page 7, filed more than a week before Staff's brief.

[14] Tr. at 420:13-22.

[15] Staff Br. at 17:7-16.

[16] Tr. at 966:23 – 967:6.

[17] The Company and counsel wish to note that their frustration is not directed at all of the Staff witnesses in this case, but only the witnesses responsible for the plethora of errors with which the Company has been forced to struggle.

II. REPLY ON RATE BASE ISSUES.

A. Staff's Plant in Service Balance.

1. Staff Has Failed to Show Any Plant Was "Inadequately Documented."

The Company has never disagreed with Staff on the Company's burden of proof; indeed, the Company has shown that it "maintains appropriate accounting records reflecting the cost of its plant."[18] Staff's witness admitted that the plant at issue is recorded in the Company's general ledger.[19] Moreover, the Company provided source documentation for $3.3 million out of $3.5 million of the plant costs requested by Staff for verification, and the Company explained why the subject original invoices dating back several years to the prior owners could not be located.[20] Thus, the Company met its burden of proof, shifting the burden to Staff to show that the amount was not reasonable.

As discussed above, Staff can't meet its burden of proof because Staff's witness couldn't explain the amount of her own adjustment.[21] One thing is for certain, the plant at issue did not cost nothing, which is really what Staff's witness is saying.[22] Further, Staff is correct that ratepayers should not pay a return on overstated or non-existent plant.[23] In order to prevail in this case, however, Staff must present substantial evidence, not just Ms. Brown's generic supposition about what could happen.[24] In this case, there is documentation to support the plant costs, yet there is no evidence of any risk to the

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[18] Bourassa Rb. at 9:3-18; Bourassa Rj. at 5:1-11.

[19] Tr. at 881:16-21.

[20] Bourassa Rb. at 9:3-18; Bourassa Rj. at 5:1-11.

[21] At trial, Staff's witness could not explain the amount of her own adjustment. Tr. at 875:17 – 879:19. In Staff's final schedules the amount is $104,983 (Staff Final Corrected Schedule CSB-6 (BVWC)), but it is now $185,038 in Staff's closing brief (Staff Br. at 4:11).

[22] Bourassa Rj. at 5:1-11.

[23] Staff Br. at 4:13-16. Staff does refer to two prior decisions but Staff makes no effort to present the facts of those cases or explain how they're similar or possibly distinguishable. *Id.* at 4:18 – 5:3. Thus, there is nothing to show that these decisions have any relevance to or precedential value in this rate case.

[24] *Tucson Elec. Power v. Ariz. Corp. Comm'n*, 132 Ariz. 240, 245, 645 P.3d 231, 237 (1982).

Company's ratepayers in this instance. Staff's engineers did not state that plant was missing, nor did RUCO raise any concern over harm to ratepayers.[25] For these reasons, Staff failed to meet its burden of proof and its adjustment should be rejected.

2. Plant Retirements.

In its brief, Staff argues that the "Company needs to appropriately retire plant."[26] This is another assertion by Staff that is not in dispute. Immediately upon discovering its failure to retire some plant, the Company proposed a substantial retirement adjustment.[27] This amount was adopted by Staff and RUCO in surrebuttal and is not in dispute.[28] Next, the Company developed a retirement policy to guide it in ensuring that plant is properly retired.[29] Staff does not appear to have any serious objection to that policy.[30] In other words, Staff identified a problem, the Company addressed it and then came up with solutions both in this case and going forward. If only Staff would have taken a similar approach to its numerous mistakes in this rate case.

B. Staff's AIAC/CIAC Balances.

1. Staff's AIAC Balance.

Regarding the AIAC balance, Staff asserts that its position should be adopted because "Ms. Brown testified that her calculations were correct, and that customer meter deposits are appropriately part of the AIAC balance."[31] Sadly, that standard has not shown to be reliable in this case. Fortunately, though, this issue is really no more than a difference of opinion over classification. The Company and RUCO classify the $2,870 difference in the AIAC balance[32] as customer meter deposits (or service line and meter

[25] RUCO Br. at 5:10-11.
[26] Staff Br. at 5:5.
[27] Bourassa Rb. at 6:11 – 7:5.
[28] Brown Sb. at 8:12-23; Moore Sb. at 7:6 – 8:8.
[29] Ex. A-31.
[30] Staff Br. at 5:19-20.
[31] *Id.* at 8:5-7.
[32] RUCO and the Company agree on an AIAC balance of $6,781,443. RUCO Br. at 5:17-18.

installation charges), but Staff includes the $2,870 in AIAC.[33] In total (AIAC plus customer meter deposits), the Company and Staff are in agreement. Staff's proposed AIAC balance is $6,784,313 and proposed customer meter deposit balance is $556,735 totaling $7,341,048.[34] The Company's proposed AIAC balance is $6,781,443 and proposed customer meter deposit balance is $559,605 totaling $7,341,048.[35] As long as the $2,780 amount is not double-counted, the ALJ does not have to weigh Ms. Brown's testimony that she was "correct."

2. <u>CIAC Amortization Should be Revenue neutral; Staff's is not and Should be Rejected.</u>

Staff states that this dispute involves a difference of $417 in the accumulated amortization balance.[36] The Company is confused on this point because Ms. Brown admitted at trial that she had accepted the Company's accumulated amortization balance.[37] This is either an unexplained change of position by Staff or a mistake. But it is the manner in which Staff constructed its CIAC amortization rate and amortization amount included in its depreciation expense computation that is most problematic. The premise underlying the use of a composite rate is the assumption that all the plant being amortized is funded with CIAC.[38] This means that the depreciation expense will be exactly offset by the amortization. In other words, it's revenue neutral.[39] Staff agrees without qualification.[40] Nevertheless, Staff removes plant assumed to be funded with CIAC, in this case land, from the plant balance in constructing its amortization rate because it

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[33] Bourassa Rj. at 12:10-19.
[34] Staff Final Corrected Schedule CSB-3 (Consolidated Systems).
[35] Applicants Final Schedule B-2, page 1.
[36] Staff's Br. at 8:13.
[37] Tr. at 955:23-25.
[38] Bourassa Rj. at 13:20-22.
[39] *Id.* at 13:22 – 14:1.
[40] Tr. at 953:19-25.

believes that the land is not depreciable.[41] Staff is wrong. Land funded with CIAC will be subject to the composite amortization of all CIAC on the Company's books and records.[42] This ensures revenue neutrality,[43] something lacking in Staff's CIAC adjustment. If we are to assume all plant is funded with CIAC, we should not then start excluding plant (without a basis) from the construction of the amortization rate. Once one starts down this path, one can start making an argument to exclude other plant amounts like transportation equipment, meters and services lines, etc. and the basis for the use of a composite rate is undermined. For this reason alone, Staff's selective plant classification scheme should be rejected.

C. Staff's Recommendations on Depreciation are Unsupported, Excessively Punitive, as well as Totally Unnecessary.

In its final brief, Staff recommends ordering the Company to convert from the group depreciation methodology to the individual asset methodology.[44] Amazingly, Staff further claims that this is "typically recommended by Staff."[45] This fable was discredited at trial when Ms. Brown was unable to identify a single instance in which a similarly situated utility, or any utility for that matter, was required to use the individual asset methodology.[46] In contrast, witnesses for both RUCO and the Company testified that the group depreciation method is the most commonly used method at the Commission.[47] This methodology is used by all of the Company's affiliates, including the largest, LPSCO, and

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[41] Staff Br. at 8:15-24. Staff again argues that it "correctly asserts" its position, a statement with which the Company disagrees.

[42] Bourassa Rj. at 13:16 – 14:24.

[43] RUCO agrees that land must be included in the plant balance. RUCO Br. at 5:22-23 ("The amortization rate must include non-depreciable plant in order to be revenue neutral.").

[44] Staff Br. at 6:9-10.

[45] *Id.* at 6:7-8.

[46] Tr. at 883:12 – 885:20. Ms. Brown also did not know the methodology used by Global Water despite recently appearing as a witness in that case.

[47] *Id.* at 304:11-23, 1040:18-24. RUCO agrees with the Company's level of accumulated depreciation, and the Company's use of the group depreciation methodology. RUCO Br. at 5:12-16.

by the majority of utilities for whom Mr. Bourassa has testified.[48] The method is generally used in conjunction with Staff's "typical and customary" depreciation rates, because it is the most administratively efficient method of keeping track of depreciation.[49]

Likewise, Staff's brief continues to perpetuate the myth that the Company does not use straight-line depreciation.[50] But, as Mr. Bourassa explained in abundant clarity, the Company currently uses straight-line depreciation.[51] What the Company didn't do was retire certain plant before it filed this rate case. But the remedy for the Company's failure to retire plant is not a change in the depreciation methodology. A failure to retire plant can occur regardless of the depreciation methodology.[52] Instead, the remedy is the Company's proposed retirement amount, which Staff and RUCO have accepted, and the retirement policy, which has not been opposed by Staff or RUCO.[53] Staff's confusing, unsupported and uncommon remedy is unnecessary and should be rejected.

III. REPLY ON INCOME STATEMENT ISSUES.

A. The APT Central Office Cost Allocations.

1. The ACC Should Not Change A Business Model That Works.

Staff and RUCO continue to oppose 98% of the APT costs even though it is ***undisputed*** that Liberty Water's shared services model has resulted in higher quality and improved utility service for the Company's customers, has provided capital to BVWC for installation of desperately needed plant that is used by BVWC in the provision of water service and has lowered the Company's operating expenses.[54] The idea that BVWC's customers don't benefit from the APT costs is preposterous ***on this record***. One need not

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[48] Tr. at 1040:21-22, 1046:23 – 1047:3.
[49] *Id.* at 1051:17-19.
[50] Staff Br. at 6:20-21.
[51] Tr. at 1035:22 – 1038:11.
[52] *Id.* at 1041:12-22.
[53] Brown Sb. at 8:12-23; Moore Sb. at 7:6 – 8:8; Staff Br. at 5:19-20.
[54] Eichler Rb. at 16-17, Ex. PE-RB1; Tr. at 387 – 392.

look any further than Liberty Water's rescue of the McLain systems for evidence of how the APT costs and services benefit BVWC and its customers.

Staff's and RUCO's justifications for denying nearly all of APT costs are unsubstantiated, and appear largely a function of Staff's and RUCO's philosophy that the lowest possible rate always is the best way to balance the interests of utilities and customers in Arizona. As a matter of law, however, the proper and correct analysis involves evaluating the APT cost allocations based on the underlying evidence, which is largely undisputed on the APT costs. Staff and RUCO should be held to the same burden of proof on their disallowances that is applied to the Company on its request for rate relief. "Mere speculation and arbitrary conclusions are not substantial evidence and cannot be determinative."[55]

2. <u>The Commission Should Approve the APT Costs Based on the Undisputed Factual Record in this Case.</u>

Throughout this case, Staff and RUCO have ignored the mountain of ***undisputed*** facts warranting approval of the APT costs. Staff's and RUCO's suggestion that BVWC benefits only incidentally from the APT costs is contrary to the underlying record—Bella Vista, Northern Sunrise and Southern Sunrise all received capital from APUC and used that capital to install over $2 million in plant and facilities that is being used to provide service to customers.[56] The record is clear that BVWC would not have access to capital without the APT costs.[57] The benefit to BVWC's customers from the APT costs is more than incidental—BVWC used capital provided by APUC from the TSX for facilities that are used and useful in providing services, which necessarily means that the APT costs are

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[55] *Tucson Elec. Power v. Ariz. Corp. Comm'n*, 132 Ariz. 240, 245, 645 P.3d 231, 237 (1982).

[56] Tr. at 541 – 542, 639 – 644, 662 – 664.

[57] *Id.* at 395 – 396 ("Q. Would that money have been available to Northern Sunrise and Southern Sunrise without the services provided by APT? A. No, they wouldn't. The primary function of the APT costs is to ensure ongoing access to capital.")

an indirect cost of BVWC's utility operations.[58]

What's more, the actual cost to ratepayers is nominal, which highlights the intrinsic value of Liberty's shared services model. In fact, Staff highlighted that intrinsic value on page 3 of its brief: "Staff recommends that the Commission approve consolidation, and ***would note that rates would be higher on a stand-alone basis because the Company could not take advantage of economies of scale.***"[59] Those "economies of scale" are a product of Liberty Water's business model, including the APT costs.

The total cost for each customer of BVWC for the APT costs is $1.09 per month or $13.08 per year.[60] That is a more than fair and reasonable charge. The benefits of the APT costs are demonstrated further by the ***undisputed*** effectiveness of Liberty Water's shared services model—among 23 comparable water companies, BVWC ranks eighth (8th) in terms of total operating costs.[61] BVWC's operating cost per customer of $396.77 is substantially less than the average cost per customer for those 23 water companies of $467.91.[62] BVWC's total operating costs per customer have decreased under Liberty Water as compared to BVWC as a stand-alone entity, which belies any concern that the APT costs artificially increase rates or do not benefit customers.[63] Finally, the beneficial nature of the APT costs is clear given that Liberty Water's cost allocation model is similar to allocation models used by Global Water (Global) and Arizona-American Water Company (Az-Am), which have been approved fully by the Commission.[64]

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[58] *Id.* at 541 – 542, 639 – 644, 662 – 664; Eichler Rb. at 12 – 17, Ex. PE-RB1.

[59] Staff Br. at 3 (emphasis added).

[60] Eichler Rb. at 16 – 18, Exhibit PE-RB3; Tr. at 390 – 392.

[61] Tr. at 392 – 393; Eichler Rb. at 25, Exhibit PE-RB4; Eichler Rj. at 14, Exhibit PE-RJ3.

[62] *Id.*

[63] Tr. at 387 – 388; Eichler Rb. at 25 – 26, Exhibit PE-RB2. Exhibit PE-RB2 shows that BVWC's operating costs per customer have been an average of 11.2% lower from 2004-2008 under Liberty Water when compared to BVWC's operation as a stand-alone entity in 2002-2003. Eichler Rb. at Ex. PE-RB2. Customers certainly benefit from lower operating expenses.

[64] Eichler Rj. at 4, 17 – 18, Exhibit PE-RJ4; Tr. at 398 – 402; Exs. A-21, A-26, A-29.

3. The Commission Should Support APUC's Business Model, Including Full Approval of the APT Costs.

This case is the paradigm of a utility doing things the right way. Liberty Water acquired Bella Vista, Southern Sunrise and Northern Sunrise, invested desperately needed capital for plant, substantially improved utility service and lowered operating expenses.[65] A charge of $1.09/month per customer is negligible given these recognized benefits.

The importance of the APT cost allocations cannot be understated. Liberty Water aspires to be a strong corporate citizen in Arizona and to continue its track record of investing capital in Arizona to enhance utility service to Arizona ratepayers. Liberty Water's rescue of the McLain systems is just one of many examples where Liberty Water has taken over troubled systems, implemented necessary system upgrades and restored high quality service to customers.[66] Liberty Water has been able to do those things as a direct result of its shared services model and access to capital resulting from the APT services.[67] Liberty Water is an entity that gets things done, and provides high quality utility service with low operating expenses. The question for the Commission is whether it wants to encourage that type of utility operation in Arizona.

A decision adopting Staff's and RUCO's denials of the APT costs or approving a small portion of the APT costs will send a clear message to good utility companies like Liberty Water that this Commission will not recognize efficient business models with continuing access to capital markets. It will discourage capital investment in Arizona and jeopardize ongoing utility services. On the other hand, a fair and just decision on the APT costs will encourage utilities like Liberty Water to invest in Arizona and commit to ongoing utility operations. For that reason, and based on the record in this case, Liberty

[65] Eichler Rb. at 12 – 17, Ex. PE-RB2; Sorensen Dt. at 12; Eichler Rj. at Ex. PE-RJ4.
[66] Eichler Rb. at 14.
[67] *Id.* at 14 – 15.

Water requests that the Commission fully approve the APT costs requested by BVWC.

4. Staff's and RUCO's Closing Arguments on the Cost Allocations Are Not Persuasive.

In their opening briefs, Staff and RUCO avoid the underlying factual record by relying on conclusory catch phrases like "improper subsidization" or "artificially higher rates." The ALJ and Commission should not fall for these misdirection tactics—***Staff and RUCO have not provided any evidence of improper subsidization or artificially higher rates***. Again, it's not enough for Staff and RUCO to simply repeat general concepts without any specific discussion of the facts in this case. "Substantial evidence is evidence which would permit a reasonable person to reach the trial court's result."[68] A Commission decision must be "rationally based on evidence of substance."[69] Staff and RUCO simply don't offer any substantial evidence supporting their disallowances.

a. Brief Summary of Staff and RUCO's Closing Arguments.

In its opening brief, Staff relies on three generic arguments to justify a 99% disallowance of the APT costs. First, "Staff does not agree that all [of] the cost pool are costs that should be allocated."[70] Second, Staff claims that the APT cost allocations do not comply with the NARUC Guidelines.[71] Finally, Staff reiterates its argument that "the amounts allocated to the regulated entities should not be in excess of the amounts that regulated utilities would incur on a stand alone basis" and Staff claims that the APT costs should be denied to avoid "creating artificially higher rates."[72] In its brief, RUCO argues that the APT costs are "insufficiently documented."[73] RUCO also argues that the

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[68] *Estate of Pouser*, 193 Ariz. 574, 579, 975 P. 2d 704, 709 (1999). *See also Denise R. v. Ariz. Dep't of Economic Security*, 2009 WL 1451452 (Ariz. App. 2009).

[69] *City of Tucson v. Citizens Utils. Water Co*, 17 Ariz. App. 477, 481, 498 P.2d 551, 555 (1972).

[70] Staff Br. at 13.

[71] *Id.* at 13 – 14.

[72] *Id.* at 14.

[73] RUCO Br. at 11.

"Company has not demonstrated that [the APT costs] are necessary for the provision of utility service or beneficial to Arizona ratepayers."[74] The ALJ should reject these arguments for the reasons set forth below.

b. <u>How the NARUC Guidelines Are Supposed to Work.</u>

In its brief, Staff's primary support for disallowance is that "Staff reviewed the underlying invoices for the costs and determined that the Company had not identified the costs as direct costs or indirect costs consistent with the NARUC Guidelines of Cost Allocation and Affiliate Transactions."[75] In turn, Staff assigned 90 percent of the APT costs to APUC and allocated the remaining 10 percent to the 17 regulated utilities owned by APUC.[76] Staff "determined that almost all of the costs were obviously attributable to the operations of APUC or one of its affiliates…."[77] RUCO simply repeats Staff's mantra.[78] Yet Staff and RUCO do not correctly apply the NARUC Guidelines relating to allocation of direct, indirect and common costs for BVWC. As a result, it is necessary to get back to basics, so to speak, by explaining the Guidelines.

Generally speaking, the "prevailing premise of these Guidelines is that allocation methods should not result in subsidization of non-regulated services or products by regulated entities unless authorized by the jurisdictional regulatory authority."[79] For allocation purposes, the costs associated with services provided to affiliates can be classified as direct, indirect or common costs.[80] Under the NARUC Guidelines, "direct costs" are defined as "costs which can be specifically identified with a particular service

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[74] *Id.* at 10.
[75] Staff Br. at 13.
[76] *Id.*
[77] *Id.*
[78] RUCO Br. at 11.
[79] Ex. R-20 at 1.
[80] *Id.* at 2.

or product."[81] For example, if BVWC incurred costs for engineering services provided solely for the Bella Vista system, then 100 percent of those costs can be directly assigned to BVWC. Direct costs can benefit more than one company, such as employee benefit administration, which should be allocated or charged to the affiliates receiving that service using a cost causative basis (such as customer count).[82]

Both RUCO and Staff rely on the principle that "costs primarily attributable to a business operation should be, to the extent appropriate, directly assigned to that business operation."[83] Staff and RUCO, however, turn that principle into an argument for disallowing the APT costs because the invoices do "not identify the costs as either direct or indirect as consistent with the NARUC Guidelines."[84] Of course, that principle doesn't apply to "indirect costs" under the NARUC Guidelines. Further, Staff and RUCO rely exclusively on the APT invoices to determine whether a cost is allocable.

In relying solely on the invoices, Staff and RUCO place form over substance—the wording on an invoice doesn't determine the nature of the APT service provided, what entity caused that cost or which entity benefited from those services. An invoice is a bill for service. It is a piece of paper—nothing more, nothing less. Whether an APT cost is an allocable cost of doing business for BVWC is determined by whether BVWC benefited from those costs or used services paid for by those costs (*i.e.,* caused those costs to be incurred). An invoice from a third-party vendor will not tell you that.

Rather than focusing on the wording of invoices, the focus of the NARUC Guidelines is identifying any and all costs that a company incurs in relation—directly or indirectly—to the services that are produced by that company.[85] All costs incurred

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[81] *Id.*
[82] *Id.*
[83] Staff Br. at 13. *See also* RUCO Br. at 10 – 11.
[84] Staff Br. at 14; RUCO Br. at 10 – 11.
[85] Ex. R-20 at 1 – 3.

directly or indirectly to produce that service must be recognized as a cost of business.[86] If only one service or product causes a cost to be incurred or benefits from a cost, then that cost should be assigned directly to that regulated utility or unregulated business that caused the cost to incur. If a cost is caused by or benefits both regulated and unregulated operations and cannot be directly assigned, then that cost should be allocated using a relevant measurement of cost causation.[87]

Fundamentally, Staff and RUCO failed to evaluate whether the APT costs are "indirect costs" under the NARUC Guidelines. "Indirect costs" are defined as "costs that cannot be identified with a particular service or product. This includes but not limited to overhead costs, administrative and general, and taxes."[88] What that means is that one company or group of companies providing one type of services (such as utility service) does not directly cause those indirect costs. Indirect costs are charged to the appropriate service to which they relate using relevant cost allocators.[89] For example, the tax and audit services provided by APT are indirect costs of both regulated utility service and unregulated electric service, which should be allocated under the NARUC Guidelines because they are legally required in order for BVWC to receive capital from the TSX and they are beneficial to BVWC's operations by facilitating access to capital markets.[90]

As noted above, indirect costs include costs such as general and administrative costs that can't be identified with a particular service or product. Those indirect or residual costs cannot be specifically attributed to one affiliate or one type of service because that affiliate or service is not the sole cause or beneficiary of the cost. Thus,

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[86] *Id.*
[87] *Id.*
[88] *Id* at 2.
[89] *Id.* at 2 – 3.
[90] Eichler Rb. at 4, 8 – 10, Ex. PE-RB1 at 4 – 7.

those indirect costs are placed in a cost pool and then allocated to all facilities that use or benefit from that cost based on proper and relevant cost allocators.[91]

Here, all of the APT cost categories are properly categorized as "direct costs," "indirect costs" or "common costs" under the NARUC Guidelines. For example, the APT management fees are incurred for capital and strategic planning for APUC's regulated and unregulated entities.[92] The fact that the management services also may benefit APUC does not mean they are not allocable. Rather, those costs are allocable indirect costs if the management services are used by or benefit the regulated utilities and unregulated facilities, which means those services are an indirect cost that can't be assigned to one specific service or product. The management services benefit BVWC by allowing access to capital funding from the TSX. The same holds true for investor communications, director fees, office expenses and escrow fees as included in the APT cost pool. Those costs are incurred for and benefit all regulated and unregulated facilities of APUC that require capital investment for their operations.[93]

The NARUC Guidelines use "Fully Allocated Costs" as the operating cost allocation principle.[94] Put simply, Liberty Water may allocate "the sum of the direct costs plus an appropriate share of indirect costs."[95] The NARUC Guidelines are based on the principle that cross-subsidization is avoided by allocating direct costs and a proportional share of indirect costs. Liberty Water's allocation model does exactly that. On this point, Staff and RUCO do not cite even one example of a specific APT cost that improperly subsidizes a non-regulated business unit, which means Staff and RUCO do not have any evidence, let alone substantial evidence, supporting their disallowances of the APT costs.

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[91] Ex. R-20 at 2 – 3.
[92] Eichler Rb. at 6 – 10, Ex. PE-RB1 at 7 – 15.
[93] Eichler Rb. at 12 – 13.
[94] Ex. R-20 at 2.
[95] *Id.*

c. <u>The APT Costs Are Not Direct Costs of APUC's Business Objectives.</u>

Instead of citing specific evidence, Staff generically argues that the APT costs are "direct costs" of APUC and should be primarily allocated to APUC—the notion being that APUC is the entity that primarily causes and benefits from the APT services.[96] That argument is contrary to the underlying record and ignores the obvious and unequivocal benefits to ratepayers noted above. Staff doesn't provide any substantive evidence in support of this argument and ultimately misuses the NARUC Guidelines.

A perfect example of Staff's and RUCO's misuse of the NARUC Guidelines is their complete disallowance of the APT management fees. Staff and RUCO deny 100% of the management fees because they claim that those fees benefit only APUC. That simply isn't true. APT incurs management fees relating to capital, financial and strategic planning for operations of APUC's regulated utilities. For example, APT incurred management fees relating to the need for capital to upgrade and remediate the McLain systems. Under the NARUC Guidelines, those types of costs are a legitimate cost of doing business and should be included in the cost pool.

Perhaps recognizing the flaw in that argument, Staff argues that "a key consideration is whether or not the costs discussed by Mr. Eichler would have been incurred if APUC did not own the companies."[97] Staff claims that "APUC would have incurred the same costs if it did not own Bella Vista, Northern Sunrise and Southern Sunrise. This demonstrates that APUC's business objectives and the activities it performs to achieve those objectives are the driving force behind the cost."[98]

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[96] Staff Br. at 13.
[97] *Id.* at 14.
[98] *Id.*

On this issue, Staff's witness has created an allocation standard out of thin air. That concept is not even remotely addressed in the NARUC Guidelines. Further, this argument is completely unsubstantiated. The evidence is ***undisputed*** that the APT costs are incurred solely for the benefit of the facilities owned by APUC and that APUC does not generate any revenue from the APT costs.[99] Staff has not shown exactly how APUC benefits from the APT costs. Staff says only that those costs are incurred by APUC in order to further APUC's business objective. But APUC's business objective does not turn the APT costs into "direct costs" of APUC under the NARUC Guidelines. Rather, the focal questions are whether BVWC uses the APT services and whether BVWC benefits from the APT costs, such as receiving capital financing from the TSX.

The testimony of Staff's witness on this issue ignores (or misunderstands) the realities of how money is raised on a stock exchange. At trial, Ms. Brown testified that APUC "would have raised that capital whether or not they owned Bella Vista or Northern Sunrise or Southern Sunrise. The benefit to the utility is incidental."[100] When asked to explain exactly how APUC would raise that capital on the stock exchange, Ms. Brown responded "I don't know. You know, I am not a finance expert. I just, you know, I don't know how I can, you know, dial a number on a cellphone, it goes to Japan. I just know it happens. So the same thing, I don't know exactly how they raise the capital, I just know that they do."[101] Ms. Brown admittedly didn't know whether a publicly traded company like APUC can sell shares on the TSX without telling investors what it will do with the money.[102] This testimony completely undermines Staff's position.[103]

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[99] Eichler Rb. at 12 – 13.

[100] Tr. at 788 – 789.

[101] *Id.*

[102] *Id.*

[103] That wasn't the only testimony jeopardizing the credibility of Staff's position. At trial, Staff's witness also analogized her disallowance to a home mortgage from Chase Bank. *Id.* at 844 – 845. According to Ms. Brown, "Chase Bank does not allocate any of its expenses to me even though they may own my house." *Id.* at 844. This testimony illustrates Staff's flawed understanding of financial markets and

5. **<u>The Fact that Customers Receive High Quality Utility Service With Low Operating Expenses Is Substantial Evidence that Customers Benefit From the APT Allocations At Minimal Cost.</u>**

At trial, Staff and RUCO agreed that BVWC provides reliable, adequate and high quality utility service to its customers.[104] It is ***undisputed*** that BVWC's operating costs are reasonable and below the operating costs of other comparable utilities.[105] That fact alone demonstrates the effectiveness of Liberty Water's shared service model, including the APT costs. Even further, both Staff and RUCO conceded that BVWC actually used and benefited from capital financing that is only available because of the services provided by APT.[106] Staff's witnesses conceded that BVWC's customers benefit from access to capital markets.[107] Mr. Chaves even testified that Staff expects APUC to use its access to capital markets to benefit BVWC.[108] Likewise, RUCO's witnesses acknowledged the benefits provided to BVWC from access to capital through APT.[109]

Despite that testimony, RUCO now claims that BVWC failed to show that the APT costs "were necessary to the provision of utility service in Arizona or otherwise beneficial to BVWC's ratepayers."[110] It is critical to highlight exactly what RUCO is arguing on this point. RUCO does not argue that the APT costs are not used by BVWC or do not benefit BVWC. Rather, RUCO argues that BVWC failed to properly document the APT costs and failed to show how BVWC benefits from the costs.

On this point, RUCO claims that "Mr. Coley further testified that the Company has

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corporate cost allocations. Anyone who has ever received a loan from a bank is aware that banks charge origination fees, closing costs, discount points, appraisal fees and other charges. All of those charges reimburse the bank for its costs to provide the loan financing, close the transaction and process the loan. Banks absolutely allocate their costs to customers.

[104] *Id.* at 638 – 640, 913.

[105] *Id.* at 392 – 393; Eichler Rb. at 25, Ex. PE-RB4; Eichler Rj. at 14, Ex. PE-RJ3.

[106] Tr. at 181, 191 – 193, 541 – 542, 628 – 631, 637 – 638.

[107] *Id.* at 541 – 542.

[108] *Id.* at 186. *See also id.* at 191 – 193.

[109] *Id.* at 628 – 631, 637 – 638.

[110] RUCO Br. at 10 – 11.

failed to demonstrate how the APT costs contributed in any way, shape or manner to the improvement of BVWC or are beneficial to the Arizona ratepayers."[111] RUCO cites pages 712-717 of the transcript in support of that statement. Unfortunately, RUCO misstates Mr. Coley's actual testimony. On page 715 of the transcript, Mr. Coley acknowledged BVWC is providing "good" utility service; and, he went on to say only that he can't tell which of the APT costs contributed to the improvement of the BVWC systems.[112] In the words of Paul Harvey, here's the "rest of the story."

In its brief, RUCO has omitted several key aspects of Mr. Coley's testimony, where he specifically acknowledged that BVWC benefited from the APT costs:

> Q. Okay. And if in fact the testimony in this case was that the parent company provided capital for system improvements at Bella Vista, you would agree with that, that the use of the capital was beneficial for the ratepayers of Bella Vista, fair?
>
> A. I am sure the ratepayers received some benefit of the updates and upgrades.
>
> Q. And if you agree, and if in fact the testimony is that Bella Vista used that capital to pay for improvements and those improvements are used for utility service, ***you would agree that the capital provided by the parent company was necessary for utility service, fair***?
>
> A. That's fair.[113]

Mr. Coley didn't stop there—he also testified that the APT costs were necessary for BVWC to provide adequate utility services to customers:

> Q. Sure. And in fact, Mr. Coley, one result of the Liberty Water acquisition of the McLain systems is that those companies are now providing adequate utility service, agreed?

[111] *Id.* at 11 (*citing* Tr. 712 – 717).

[112] *Id.* at 715 ("Q. Can you tell, though, from the APT costs which of those costs contributed in any way, shape or manner to the improvement of the system or are beneficial to develop as to ratepayers? A. Not whatsoever.").

[113] *Id.* at 641 – 644 (emphasis added).

> A. That's my understanding, yes.
>
> Q. Which you also agree they were not doing before the Liberty Water acquisition, fair?
>
> A. I have heard plenty about the system that you were talking about, McLain, and I would agree that they weren't, were not providing adequate service.
>
> ***Q. Which would demonstrate to you, would it not, that the services provided by the parent company were necessary for the provision of utility service by the former McLain systems?***
>
> ***A. I would agree.***[114]

That testimony, along with the additional evidence noted above, clearly shows that the APT costs are used by and benefit BVWC's utility operations, which necessitates that they be allocated under the NARUC Guidelines. The question then becomes whether Liberty Water's methodology results in fair and reasonable charges for the APT costs.

The answer to that question is an unequivocal YES. A simple cost-benefit analysis demonstrates these costs are just and reasonable. The benefits provided by the Liberty Water business model substantially outweigh the minimal costs to BVWC's customers. For instance, APT incurs license fees to ensure that APUC can participate in the TSX.[115] The costs to BVWC's customers for the APT license fees are less than 1¢ per month.[116] Similarly, investor communication costs are incurred by APT to comply with the filing and regulatory requirements of the TSX and Canadian law.[117] At trial, Mr. Coley acknowledged that Liberty Water must comply with these legal requirements as a publicly traded company.[118] The cost to BVWC's customers for shareholder communications is 4¢

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[114] *Id.* at 639 – 641 (emphasis added).

[115] Eichler Rb., Exhibit PE-RB1 at 11 – 13.

[116] Eichler Rb. at 17, Exhibit PE-RB3.

[117] *Id.*, Exhibit PE-RB1 at 12 – 13.

[118] Tr. at 642 – 643.

per month.[119] Taxes are paid on behalf of BVWC at the parent level as part of a consolidated tax return.[120] The cost to BVWC's customers for the APT tax services are 14¢ per month.[121] Audit services are necessary to ensure that the regulated utilities are operated in a manner that meets regulatory requirements.[122] The costs to BVWC's customers for the APT audit fees are 21¢ per month.[123] A total APT allocation of $125,830 to BVWC is justified by substantial evidence and more than just and reasonable.

6. Staff's and RUCO's Remaining Arguments Are Illusory.

The remaining arguments raised by Staff and RUCO in their opening briefs are illusory and should be ignored. BVWC briefly addresses these arguments below.

a. A Cost Allocation Model That Benefits Customers of Global and Az-Am Also Benefits Customers of BVWC.

On page 15 of its closing brief, Staff questions the comparison of Liberty Water's cost allocation model to Az-Am's cost allocation model. Staff's attempt to sweep the comparisons to Global and Az-Am under the rug should be ignored. The facts of this case demonstrate that Liberty Water's cost allocation model is virtually identical to the models approved for Az-Am and Global Water.[124] By approving the cost allocation models for Az-Am and Global Water, the Commission has determined that those models are necessary and beneficial to customers of Az-Am and Global Water. Because the "Commission should apply the same set of standards and principles for similarly situated utilities," the Commission also must approve Liberty Water's cost allocation models as necessary and beneficial to BVWC's customers.[125]

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[119] Eichler Rb. at 17, Exhibit PE-RB3.
[120] *Id.* at 8 – 10, Exhibit PE-RB1 at 14; Tr. at 412 – 416.
[121] Eichler Rb. at 17, Exhibit PE-RB3.
[122] *Id.*, Exhibit PE-RB1 at 13 – 15.
[123] Eichler Rb. at 17, Exhibit PE-RB3.
[124] Tr. at 403 – 405, 667 – 670, 780 – 781; Exs. A-21, A-26, A-30.
[125] Tr. at 767 – 768.

Staff hasn't provided any reason for treating Liberty Water differently than Az-Am or Global on the cost allocations. Instead, Staff claims that Az-Am and Liberty Water are not comparable because "[t]he $1.7 million that Staff allowed for Arizona American includes not only the parent Company's corporate allocation, but also the cost to manage the Arizona operations…."[126] That statement is an error by Staff. In Az-Am's 2005 rate case, Staff approved $1,657,590 in corporate cost allocations for Az-Am's Anthem/Aqua Fria wastewater district[127] plus an additional $504,984 in wages (plus added benefits) for Az-Am's on-site operations.[128] Staff recommended nearly double the corporate costs plus direct labor for Az-Am that Staff recommended for BVWC in this case, which is curious given that Az-Am's Anthem/Agua Fria Wastewater District had 8,047 customers in the 2005 test year compared to BVWC's 9,610 customers.[129]

b. <u>RUCO's Favorite Red Herring--Corporate Office Rent.</u>

On pages 12-13 of its brief, RUCO argues that the APT rent charges should be denied because "[t]he Company has not demonstrated that the affiliate costs contained within the cost pool were incurred at the lesser or cost and market."[130] On this issue, ¶ D(2) of the NARUC Guidelines states: "*Generally, the prices for services, products or the use of assets provided by a non-regulated affiliate to a regulated affiliate should be at the lower of fully allocated cost or prevailing market prices*."[131] RUCO attempts to turn that language into an argument for disallowing the APT costs.

That argument is flat contradicted by the evidentiary record in this case. Initially, it's ***undisputed*** that the rent charges for the corporate office are within prevailing market

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[126] Staff Br. at 15.

[127] Ex. A-30.

[128] *See* Staff Schedule GWB-9, Operating Income Statement—Test Year and Staff Recommended, in Docket No. WS-01303A-06-0403 (**attached as Reply Brief Exhibit A**).

[129] *See* Az-Am Schedule H-2 for Anthem/Agua Fria Wastewater, Docket No. WS-01303A-06-0403 (**attached as Reply Brief Exhibit B**).

[130] RUCO Br. at 12.

[131] Ex. R-20 at 4, ¶ D(2) (emphasis added).

prices, ***a fact which RUCO concedes in its opening brief***.[132] Even so, the focus of RUCO's argument is determining "whether the ratepayers' costs would have been less than the monthly rent paid to Bristol Circle, the affiliate, if APT had bought or constructed the building directly."[133] The gist of RUCO's position appears to be that APT should pay for and construct the office building if the monthly cost for financing and constructing the building is less than the rent charged by Bristol Circle. The NARUC Guidelines don't support that argument. The focus of the NARUC Guidelines is whether the total rental charges incurred by APT (i.e., the fully allocated cost) is more than prevailing market prices. The construction cost of the building isn't relevant to whether the rent incurred by APT is more or less than prevailing market prices. Because RUCO has raised this issue, however, the Company is forced to incur more rate case expense to respond.[134]

As stated in Exhibit R-19, it's ***undisputed*** that "the market studies provided by the Company demonstrate that the rent charged to the Company by APT falls within market prices as established by comparable transactions."[135] Further, "APT allocated rent for the corporate office to the regulated utilities owned by the parent company in the amount of $5,545.50 per month. In turn, APT allocated a total of $805.21 in monthly rent to the Bella Vista Companies or $0.08/month per customer."[136] Apparently RUCO wants to argue over the difference between the monthly costs for APT to construct, operate, maintain and finance a 12,000 square foot office building and the $805 rent charge to BVWC in this case.[137]

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[132] Ex. R-19. *See also* Staff Br. at 13 ("...the Company provided documentation supporting its position that APT is paying its Affiliates market rent...").

[133] RUCO Br. at 13.

[134] In that respect, this corporate office rent argument is similar to RUCO's argument that Mr. Bourassa overstated AIAC realization. Tr. at 236 – 237. Unfortunately, RUCO didn't abandon this rent argument when it dropped the AIAC realization line of attack.

[135] Ex. R-19 at 3.

[136] *Id.*

[137] If we assume APT had constructed the corporate headquarters building for $5,000,000 and financed it with a 15 year loan at an interest rate of 6.5%, the monthly loan payments would be $43,555.37. In turn, if

RUCO's argument also ignores the ratemaking treatment of that building. If APT had constructed the office building for, let's say, a cost of $5,000,000, then a share of that cost would be included in BVWC's rate base. If BVWC was allocated 3.52% of that construction cost (using the 3.52% mentioned on page 14 of RUCO's opening brief), then $176,000 (minus depreciation) would be included in rate base and BVWC would earn a return (at 9.2%, BVWC would be entitled to an additional $16,192 in revenue before gross-up for taxes), not to mention that depreciation on the $176,000 would be included in operating expenses plus a share of repairs, maintenance, taxes and insurance on the office building. It is doubtful that RUCO really wants to go down that road and this rent argument should be summarily denied.

c. RUCO's Revenue Based Allocation Methodology.

On pages 14-16 of its brief, RUCO proposes an allocation model based on total revenue. That argument is outside the record in this case—RUCO did not propose a revenue based allocation method during the hearing or in pre-filed testimony. RUCO states that "Mr. Coley testified (as RUCO and/or Staff witnesses have in prior Liberty Water cases) that the better method would be to bill utilities for direct costs and allocate indirect costs on a revenue basis rather than treating each facility the same regardless of revenue or customer size."[138] Unfortunately, RUCO misstates the testimony again.

In reality, Mr. Coley testified that "I have heard that Mr. Tremblay did some calculations back in, I think, the LPSCO and provided to Judge Nodes on various different drivers of allocation methods. And revenue would produce about a 17 percent first allocation factor as opposed to the company's nearly 25 Is that low enough? Is 17

24.29% of that rent was allocated to the regulated utilities ($10,579.60), then 14.52% of that amount would be allocated to BVWC, which equals $1,536.16 or nearly double the amounts allocated to BVWC in this case. Of course, if APT had constructed and paid for the building, BVWC would be responsible of its share of insurance costs, property taxes, building repairs, operation and maintenance costs, etc.

[138] RUCO Br. at 14.

percent low enough to satisfy RUCO? I am not certain. Certainly it is better than 25."[139] That was all Mr. Coley said on this issue. Ultimately, Mr. Coley testified that "I do not have a recommendation" for a cost allocation methodology to be used by Liberty Water.[140] In fact, Mr. Coley accepted Liberty Water's two-phase methodology.[141]

In the LPSCO case, Liberty Water evaluated methodologies based on revenue, operating costs and plant.[142] Using those drivers, the percentages for the initial phase of the allocation to the 17 regulated utilities were 17.02% (revenue), 28.87% (operating costs) and 29.74% (plant).[143] When weighted equally, the result is an allocation of 24.96% to the 17 regulated utilities, roughly identical to the 24.29% in this case.[144]

Even though the pros and cons of those allocation drivers were not presented or considered in this case, RUCO now suggests using a one-step allocation model based on revenue.[145] Revenue is generally disfavored as an allocation driver because revenue allocations aren't based on cost causation or use of resources. For example, the evidence presented at hearing in the LPSCO case established that revenue alone does not reflect to what extent various facilities use the APT services.[146] In 2008, APUC's utilities division accounted for 29% of the total controllable operating costs of APUC while only producing 17% of the revenue, which shows that greater expenses are required to generate revenues for the regulated utilities.[147] Revenue based allocations also are subject to fluctuations in

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[139] Tr. at 678 – 679.

[140] *Id.* at 681.

[141] *Id.* at 680 ("And as I stated back in the Rio Rico hearing that I did not agree with the methodology, I don't agree with it here, but I am accepting it just to use it.").

[142] *See* January 6, 2010 Transcript in Docket No. W-01428A-09-0103 (consolidated) at 413 – 416; January 7, 2010 Transcript in Docket No. W-01428A-09-0103 (consolidated) at 456 – 460 ("LPSCO Tr."); Ex. A-12, "Allocation Methodology Analysis," in Docket No. W-01428A-09-0103 (consolidated) ("LPSCO Ex. A-12").

[143] LPSCO Tr. at 413 – 416, 456 – 460; LPSCO Ex. A-12.

[144] LPSCO Ex. A-12 at 2.

[145] RUCO Br. at 14 – 15.

[146] LPSCO Tr. at 432; LPSCO Ex. A-12.

[147] *Id.*

revenue for unregulated operations. For BVWC, an allocation based on revenue would yield $68,850.10 in APT costs allocated to BVWC.[148] As stated in prior rate cases, Liberty Water is willing to consider alternative allocation methodologies and drivers if requested by the Commission.

B. <u>There's Nothing "Inexplicable" About the Company's Rate Case Expense, and the Only Thing "Unreasonable and "Unnecessary" are the Adjustments Proposed by Staff and RUCO.</u>

Initially, the Company projected total rate case expense of $450,000.[149] This estimate was made at a time when it was unknown what issues, including the requested consolidation, might be in dispute. It was based on experience with due regard for the fact that three separate applicants were making four separate filings before an agency where rate cases rarely take the straightforward path. Between the application and the date Mr. Eichler took the stand to testify to the final rate case expense, there were four more filings of testimony, two by the Applicants, substantial discovery, including substantial informal discovery directed at Staff's error-plagued direct filing.[150] There have also been six days of trial (with transcripts), four sets of final schedules and two rounds of briefing, along with more than $10,000 of copying and mailing costs. Someday, there will also be a ROO, possibly exceptions (but hopefully not), an Open Meeting appearance and substantial post-decision compliance. For all of this, the Company seeks a total of $375,000 amortized over three years, a reduction of $75,000, or a nearly 20 percent decrease from the initial request.

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[148] According to APUC's 2008 Financial Report, the total revenue for all facilities owned by APUC in 2008 was $213,796,000. The 2008 total revenue for the Utilities Division was $35,233,000, which is 17% of the total revenue. According to the 2008 Annual Reports for Bella Vista, Northern Sunrise and Southern Sunrise, BVWC's total revenue in 2008 was $4,123,206, which is 1.93% of the total revenue. In BVWC's Final Schedules, the total Central Office Cost pool is $3,567,363. Allocating those costs based on revenue would yield $68,850.10 in APT costs allocated to LPSCO (3,567,363 x 0.0193).

[149] Bourassa BVWC Dt. at 12:9-10; Bourassa NSWC Dt. at 11:2-6; Bourassa SSWC Dt. at 11:2-6; Bourassa Rb. at 24:18 – 25:2.

[150] Tr. at 420 – 423.

When challenged, the utility faces a heavy burden to justify rate case expense, and this case has been that way for Liberty Water and its legal counsel. That's okay, there is a lot of money involved, and it will be recovered from ratepayers. That the Company has done so in this case is clearly illustrated by the undisputed evidence and justified by the equitable application of plain old common sense.

Staff argues that the Company's requested rate case expense is "inexplicably higher than similar companies."[151] Staff's argument suffers from a number of flaws. First, as noted above on page two, Staff does not even know how much the Company is requesting.[152] Obviously, the Company's request will compare less favorably when it is inflated. This is especially true when the comparable is deflated, which, as also noted above, occurs with respect to the Global Water expense level used in Staff's brief. In fact, $375,000 of total rate case expense amortized over three years compares very favorably to the $400,000 of rate case expense that Global Water requested, Staff and RUCO supported, and the Commission granted.[153]

Second, although Staff refers to three other rate dockets in comparison, Staff offers no evidence regarding the specifics of these cases. Did any of these rate cases involve a consolidation request that the parties agreed is in the public interest, but which had to be supported by evidence and explained in the briefing for the benefit of the ALJ and Commission? How big were the systems involved in these rates cases and did any of them have a background like the former McLain systems, which exacerbated the costs to bring these cases? It is not enough for Staff to just throw out numbers and say the Company's request does not compare favorably. To meet its burden Staff must provide substantial evidence.[154] It provided none.

[151] Staff Br. at 16:12-13.

[152] *Id.* at 16:14 (asserting that the Company is requesting $450,000 of rate case expense).

[153] Tr. at 967:4-8.

[154] *Tucson Elec. Power v. Ariz. Corp. Comm'n*, 132 Ariz. 240, 245, 645 P.3d 231, 237 (1982).

Third, Staff's claim that "the Company has done little to minimize the components of rate case expense because it used outside consultants and lawyers" is nothing but Ms. Brown's unsupported opinion, an opinion contradicted by the facts in evidence.[155] Staff made absolutely no effort to show how the use of an outside consultant and counsel disproportionately impacted rate case expense in this case versus its comparables. In fact, the Company only hired one outside consultant. It is common knowledge that other utilities use outside consultants, including the three utilities in Staff's comparison. Global Water, Arizona Water and Arizona-American also each used outside counsel, same as the Company. Thus, Staff's claim that the Company's use of outside counsel and consultants increased rate case expense fails. In fact, the singular reason for rate case expense being higher than it should have been in this case is the frequent mistakes made by Staff. Therefore, Staff's comparison analysis should be given virtually no weight.

Like Staff, RUCO does not know how much the Company is seeking in rate case expense.[156] This is true despite the fact that the Company explained its modified request at trial and then included the amount of $375,000, not $450,000, in its final schedules.[157] The Company assumes this is simply a mistake, rather than the type of misleading assertion of fact that has become all too common place in RUCO's filings in Liberty Water's rate cases. RUCO's arguments in support of their reduced rate case expense are, however, another story. Those arguments are flawed for several reasons.

First, RUCO asserts that the "Company's request for rate case expense is not adequately supported, reasonable or necessary."[158] RUCO's argument, however, is primarily based on its claim that it was forced to calculate its recommended rate case

[155] Staff Br. at 16:22-23.
[156] RUCO Br. at 16:15.
[157] Tr. at 420; Applicants Final Schedule C-2, page 7.
[158] RUCO Br. at 17:5-10.

expense from a handwritten estimate given to RUCO in another rate case.[159] This position would be laughable if it weren't so disingenuous. RUCO wasn't forced to rely on this estimate, which was not written with this rate case in mind in any way. RUCO chose to rely on the estimate because RUCO inexplicably declined to review any of the evidence of actual rate case expense made available to RUCO after February 2010, at least not until after the evidentiary hearings were concluded and its witnesses were no longer subject to cross-examination.[160] Therefore, the Company does not know why RUCO chose to stick with the estimate-based calculation of rate case expense in the BMSC rate case for this case.

Second, RUCO has made little effort to consider the specific circumstances in the two cases being compared. For example, RUCO ignores the fact that the BMSC rate case involved one utility with under 2,000 customers, not three utilities with a total of nearly 10,000 ratepayers, seeking to consolidate into one entity with one set of rates in this docket. Instead, RUCO simply concludes that the issue of consolidation wasn't disputed.[161] That does not relieve the Company of its obligation to make a record, nor does it assure the outcome of a Commission vote in the Company's favor. Nor did the fact that Staff supports and RUCO does not oppose consolidation eliminate the large amount of paperwork that had to be prepared at multiple stages of this rate case. Finally, RUCO's attempt to rely on Staff's comparable analysis fails[162] for the same reasons the Company has already asserted this analysis isn't credible in the first place. Thus, RUCO has failed both to rebut the Company's showing that its requested rate case expense is supported by substantial evidence, and to meet its own burden to show that its requested rate case expense of only $100,000 amortized over three years is reasonable.

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[159] *Id.* at 17:5 – 19:7.
[160] Tr. at 292:4-9, 308:15 – 309:2, 311:9 – 312:2; RUCO Br. at 19:20 – 20:8.
[161] RUCO Br. at 19:10-11.
[162] *Id.* at 20:8-20.

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That number is not a mistake. Although RUCO's calculation of rate case expense for this rate case using the handwritten BMSC estimate is an already anemic $200,000, RUCO wants the Commission to award $100,000 because, according to RUCO, the shareholders benefit equally from rate case expense.[163] Of course, RUCO completely ignores the fact that the Company cannot raise its own rates. This long process is dictated by others and requires substantial outlays of cash that are never recovered in full.[164] Meanwhile, the Company has to wait to earn a return on the plant the Commission actually allows in rate base. In short, the shareholders of every utility already absorb a substantial unrecovered cost in order to obtain rate relief. A utility that has acted reasonably and kept its rate case expense to a prudent level should not be required to shoulder even more of the burden of obtaining rate relief.

IV. REPLY ON COST OF CAPITAL ISSUES.

A. Reply to RUCO.

As noted in the Company's closing brief, the differences of opinion between Mr. Rigsby, who used a DCF and a CAPM with both water and gas sample utilities, and Mr. Bourassa, who used the same models, albeit with the same six water utility sample group used by Staff and the Commission, is nothing new.[165] The specifics of the dispute between the two cost of capital experts is set out in full detail in their pre-filed testimony, as well as argued in the Company's closing brief. With one exception, RUCO's brief in this case offers nothing that has not already been addressed by the Company or the Company's affiliate RRUI in its pending rate case.[166] The exception is RUCO's assertion

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[163] *Id.* at 21:18-21.

[164] The Company has paid all of its rate case expense in a timely manner and expects to incur more than the amount requested. Tr. at 421:19 – 422:12.

[165] *See* Applicants Br. at 55:6-20.

[166] *See* Bourassa COC Rb. at 23 – 34; Bourassa COC Rj. at 27 – 44, Applicants Br. at 52 – 57. *See also* Rio Rico Utilities, Inc.'s Initial Closing Brief, filed April 19, 2010 in Docket No. WS-02676A-09-0257 ("Rio Rico Closing Brief"), at 38 – 70, and Rio Rico Utilities, Inc.'s Reply Closing Brief, filed May 10, 2010 in Docket No. WS-02676A-09-0257 ("Rio Rico Reply Brief"), at 23 – 42 (incorporated herein by reference).

that the Commission should adopt a hypothetical capital structure for Northern and Southern Sunrise if consolidation is denied.[167] The Company's opposition to RUCO's hypothetical capital structure is set forth in its prefiled testimony.[168] A 6.27 percent cost of debt for the former McLain systems is simply unrealistic.

B. Reply to Staff.

Staff asserts that its recommended 9.3 percent ROE "should be adopted by the Commission because it is based on sound and well accepted cost of equity estimation methodologies that have been consistently utilized by this Commission."[169] These methodologies include the DCF, the CAPM and the Hamada formula. Thus, by Staff's reasoning, the Commission should also adopt Mr. Bourassa's recommended 10.9 percent return on equity. Mr. Bourassa also used the DCF and CAPM, with the same six sample companies as Staff, as well as the Hamada method in formulating his recommendation.[170] In the alternative, since the Commission is faced with two ROEs that, according to Staff, should be adopted because they use the right methods, Staff's and the Company's ROEs could be averaged together to reach a 10.1 return on equity.[171]

The point to be made here is that Staff simply plugged its witness into its model and now assumes the result will be adopted because that's what the Commission always does.[172] But Staff has substantially overstated the Commission's prior approval of the Hamada formula.[173] It is true that in each of the decisions referenced by Staff, and in other decisions, the Commission has approved the use of the equation developed by

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[167] RUCO Br. at 28:7 – 29:6.

[168] Bourassa COC Rj. at 40 – 44; Sorensen Rb. at 11 – 12; Sorensen Rj. at 4 – 6.

[169] Staff Br. at 19:16-18.

[170] *See* Applicants Br. at 52:13-21.

[171] RUCO's witness only used the DCF and CAPM, and according to Staff, the Commission should adopt the ROEs that also use Hamada. If RUCO's recommended 9 percent ROE were averaged with Staff and the Company's 9.3 and 10.9, the result would be 9.7 percent, which the Company feels is still too low.

[172] Staff Br. at 19:16-18.

[173] *Id.* at 21:6-8 *citing* three prior Commission decisions, however, without specific citation, any discussion, or explanation.

Professor Hamada of the University of Chicago to account for a corporation's financial risk related to its capital structure.[174] That equation, called the Hamada equation or Hamada formula, incorporates capital structure theory into the CAPM. The CAPM is market-based model. Therefore, as Mr. Bourassa has explained, the inputs must be market inputs.[175] In short, while the Commission has approved the use of the Hamada equation to account for financial risk, the Commission has never approved the incorrect use of book inputs into the model.[176] Therefore, Staff's ROE is too low, largely because of its improper and ill-advised application of the Hamada adjustment.

V. **<u>REPLY ON RATE DESIGN ISSUES.</u>**

A. **<u>Staff's Rate Design – Conservation or Revenue Shifting?</u>**

Staff seeks to defend its rate design with the same sort of conclusory but unsupported assertions discussed elsewhere in this brief.[177] Yet Staff's revenue shifting is self evidenced in the first sentence of this section of Staff's brief: "Staff recommends a rate structure that is similar to that which is currently in place, but increases the break-over points for larger meters."[178] Staff's focus on increases to larger meters results in rate decreases to smaller meter customers, which customers make up the vast majority of the customers.[179] Thus, the message actually sent to most customers is not that water is a precious and finite resource, but that water is getting cheaper to buy and use.[180] The price of this message is much higher costs for larger users, which include known "water

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[174] *See* Decision No. 69440 (May 1, 2007) at 17 – 19; Decision No. 68858 (July 28, 2006) at 22 – 27; Decision No. 70209 (March 20, 2008) at 27 – 29.

[175] Bourassa COC Rb. at 9:9 – 10:8.

[176] *See* Decision No. 69440 at 17 – 19; Decision No. 68858 at 22 – 27; Decision No. 70209 at 27 – 29.

[177] Staff Br. at 17:21-24. Notably, Staff does not offer a single record citation for any of the claims it makes regarding its rate design.

[178] *Id.* at 17:21-22.

[179] Tr. at 999:4-15 (Ms. Brown testifying that 77% of customers would receive a 2.5% rate decrease under Staff's rate design even though Staff is recommending a 10.6% overall increase).

[180] *Id.* at 1055:4 -17.

wasters" like schools and hospitals, and increased revenue instability for the utility.[181] Fortunately, it isn't necessary to overburden a small group of customers that use water wisely but in large amounts, nor further increase the regulatory risk faced by the Company. That's because the rate design proposed by the Company, and RUCO, strikes a fair balance between conservation, gradualism and cost of service.[182]

At trial, Staff defended its rate design as just "what it is."[183] In its brief, Staff further defends its revenue shifting by criticizing the Company's cost of service study (COSS).[184] Staff's witness didn't do a COSS, and could not provide any testimony regarding the alleged impacts of those concerns over the COSS.[185] In contrast, Mr. Bourassa responded to Staff's criticism of his COSS in great detail.[186] First, he explained his own cost allocation factors and how he used them. Second, he explained his disagreement with Ms. Brown's criticisms. Third, he followed Ms. Brown's reasoning (she made no specific suggestions) to determine the impact of changing his allocation factors consistent with Ms. Brown's assertions. The result, a negligible impact on the allocation of revenue between larger and smaller meters.[187] In other words, Staff's entire COSS argument is a red-herring.

In sum, the Company is aware that the Commission often adopts Staff's rate designs without much scrutiny in the name of conservation of the State's precious resource. But the dispute between Staff and the Company is not about conservation – all parties propose inverted tier rate designs to promote conservation. Instead, the dispute is about whether to select a rate design that balances a number of relevant factors, the

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[181] Bourassa Rb. at 35:12 – 37:7; Bourassa Rj. at 28:12 – 31:8.
[182] *E.g.*, Tr. at 1044:25 – 1046:19, 1053:11-22; Bourassa Rb. at 36:21-25.
[183] Tr. at 996:15-16.
[184] Staff Br. at 18:1-6.
[185] Tr. at 1000:12 – 1002:15.
[186] Bourassa Rj. at 31:9 – 34:21; Tr. at 1042:17 – 1046:19.
[187] Tr. at 1043:17-21; Bourassa Rj. at 34:17-21.

Company and RUCO's approach, or one that places the goal of conservation at risk along with the Company and some of the customers. The Company suggests that the former, not the latter, furthers the public interest.

B. **The Company's Proposed HUF Tariff is Unlikely to Result in Regulatory Armageddon.**

To be absolutely clear—the Company is merely asking that cash sitting in a separate and specially designated bank account not be deducted from its rate base.[188] The Company is not asking that it be allowed to earn a return on plant built with someone else's money. When plant is built using the HUF funds that used to be in the bank, the amounts spent on that plant would be included in the Company's CIAC balance, which is deducted from rate base.[189] Nor is the Company asking for authority to use those funds for anything but capital improvements needed to serve growth, as called for in the tariff's restrictive language.[190] Frankly, the Company and its counsel still don't see what's wrong with this proposal.

Staff and RUCO, on the other hand, have gone to great lengths to convince the ALJ and Commission that the Company's suggestion is some sort of insidious scheme to cause more work for Staff while padding the shareholders' pockets at the customers' expense.[191] These "chicken-little" claims simply cannot stand up to a common sense application of the evidence and law. Nor can they hide Staff and RUCO's real motivation—to defend a one-sided elimination of rate base that benefits the customers directly at the shareholder's expense. Each of Staff's and RUCO's principal arguments is addressed below.

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[188] Sorensen Rj. at 3:2 – 4:21; Tr. at 93:2 – 94:15, 115:3-16.
[189] *Id. See also* Tr. at 258:22 – 261:2.
[190] Tr. at 104:23 – 105:18; Ex. A-23.
[191] *See, generally,* Staff Br. at 10:6 – 11:12; RUCO Br. at 31:16 – 36:2.

1. Reply to Staff's Opposition to HUF Language.

Staff Argument: "Staff Believes HUFs are contributions and should be deducted from rate base like all other contributions."[192]

Company Response: Staff is entitled to its belief, but Staff's witness testified that HUFs are what the Commission says they are.[193] The NARUC definition Staff relies upon certainly does not dictate otherwise. Notably, Staff only cites part of the definition, leaving out the part the Company relies upon.[194] That's because Staff has been entirely unable to reconcile its position with the language in the same definition that reads "and which is utilized to offset the acquisition, improvement or construction costs of the utility's property, facilities or equipment used to provide utility service to the public."[195] If this language does not mean that CIAC does not exist until something is spent on plant, then what does it mean? It is safe to assume the authors did not intend for it to have no meaning, as Staff has interpreted and represented this definition to the Commission. Likewise, Staff's reference to the NARUC subcommittee definition has no persuasive value.[196] While CIAC are payments made by third parties, so are AIAC, which are not CIAC, nor are HUFs always treated by the Commission as CIAC.[197]

Staff Argument: "Additionally, the Commission has taken the position that hook-up fees, in and of themselves should be treated as CIAC."[198]

Company Response: Generally that's true, however, the Commission has never been asked to approve language that would not classify unexpended HUFs as CIAC.[199] If

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[192] Staff Br. at 10:19-20.

[193] Tr. at 990:24 – 991:1. RUCO's witness agreed as well. *Id.* at 607:12-18, 609:10-18.

[194] *Compare* Staff Br. at 10:23 – 11:1 *with* Brown Sb. at 12:4-18 and Sorensen Rj. at 4:3-16. Notably, the definition is misquoted in Ms. Brown's surrebuttal. Brown Sb. at 12:16-18.

[195] Sorensen Rj. at 4:5-11.

[196] Staff Br. at 11:3-6.

[197] Tr. at 573:25.

[198] Staff Br. at 11:6-7.

[199] *See* Tr. at 570:2-8.

this language is approved, HUF funds would not be classified as CIAC while they are just sitting in the bank.[200] Given Staff's oft-cited view that all cases are heard on their own merits, surely Staff will agree that the Commission can consider the Company's request. Again, as explained above, the Company is not asking that HUFs not be treated as CIAC, just not while sitting in the bank.

Staff Argument: HUFs are "clearly CIAC" because these funds are "provided by someone other than the Company" and are "non-refundable and used to fund the construction of plant."[201]

Company Response: So what? At the time these monies from someone else are sitting in a bank they are not being used to fund anything and provide no benefit to the utility.[202] This is the point of the Company's proposal—deduct the amounts from rate base when they benefit the utility by funding plant with someone else's money, not before.

2. **Reply to RUCO's Opposition to HUF Language.**

RUCO Argument: HUF funds "must be recorded [as CIAC] upon receipt in compliance with existing rules, NARUC standards, and the precedence [sp] established by the prior ruling of the Commission."[203]

Company Response: RUCO cites two prior Commission decisions to support this bold proposition concerning what the Commission must order the Company to do.[204] As RUCO's witness admitted, however, these decisions do not address the issue before the Commission in this case.[205] RUCO never identifies the alleged rule that says HUF funds sitting in bank accounts must be must be deducted from rate base. And RUCO's alleged

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[200] *Id.* at 568:22-25.
[201] Staff Br. at 11:8-11.
[202] Sorensen Rj. at 3:14-17; Tr. at 104:23 – 105:18.
[203] RUCO Br. at 31:19-20.
[204] *Id.* at 31, n. 61 and n. 67.
[205] Tr. at 556:12-20.

NARUC violation is unsubstantiated. RUCO cites the same NARUC definition cited by all parties and then says its interpretation is correct because Ms. Brown says that's how NARUC wants it.[206] Ms. Brown was not qualified as an expert on NARUC—she simply relied on treatise materials without independent knowledge of how NARUC would interpret the Company's proposal in light of its definition of CIAC. As discussed above, the same NARUC definition of CIAC lends itself to the Company's argument that HUF funds are only CIAC once the funds are "utilized to offset" something. Thus, it is up to the Commission to decide. And the decision is not whether HUFs will be CIAC, but when.

RUCO Argument: "It does not appear that the funds are going to be held in a third party account and held in trust."[207]

Company Response: The Company has no idea how RUCO came to this conclusion. Both the tariff language itself and the very testimony cited by RUCO show that the HUF monies will be held in a separate, interest bearing bank account, where even the interest goes to the account, not the utility.[208]

RUCO Argument: "According to the testimony of Mr. Sorensen, the Company will have beneficial use of the HUF funds."[209]

Company Response: RUCO offers no citation to the record to support this claim, and there is no evidence to support it in the record. Mr. Sorensen clearly testified that

[206] RUCO Br. at 33:12 – 34:5.
[207] *Id.* at 32 *citing* Tr. at 114 – 115.
[208] Tr. at 114:19 – 115:6 ("we are holding it separately, identifiable, restricted cash, interest bearing with interest accruing to the fee account."). *See also* Applicants' Notice of Filing, filed September 16, 2010, at Exhibit 6, Section IV(H) ("All funds collected by the Company as off-site hook-up fees shall be deposited into a separate unaffiliated third-party interest bearing bank account and used solely for the purposes of paying for the costs of installation of off-site facilities that will benefit the entire water system.").
[209] RUCO Br. at 32:13-14.

there is no benefit to the Company while the funds are sitting in the bank.[210] It is one thing to present evidence in a favorable light and quite another to just make it up.

<u>RUCO Argument</u>: Denial will result in no harm to the Company.[211]

<u>Company Response</u>: That this assertion is without merit is easily illustrated. Utility A has $10 of plant in service and $3 of HUF funds sitting in a bank account. In Utility A's rate case, the HUF funds are included in CIAC and deducted from rate base, leaving the utility with a rate base of $7. In Utility B's rate case, the HUF funds are not deducted from rate base because they are sitting in the bank. As a result, Utility B has a rate base of $10. Utility A is harmed because $3 of otherwise used and useful plant is not generating any return. On the other hand, take Utility C with $10 of plant in service and $3 of HUF funds, which it used to build $3 worth of plant. In Utility C's rate case, the plant in service goes up to $13, the CIAC balance goes up by $3 and the rate base is $10. Obviously, Utility A, the Company if its proposal is denied, is harmed because $3 of plant that would otherwise be in rate base is being taken out. While the harm suffered by Utility A is obvious, ratepayers are not harmed by the Company's proposal, except in the sense that a deduction to rate base is delayed until such time as the utility actually uses the money it has been given to pay for plant.[212]

<u>RUCO Argument</u>: Staff will have to "chase the CIAC."[213]

<u>Company Response</u>: RUCO takes the "sky is falling" approach to the extreme in this final argument against the proposed HUF referring to an "incredible burden," "potential" harm to ratepayers and the possibility of "outright fraud" and "innocent

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[210] Tr. at 93:23 – 94:11, 104:23 – 105:18.

[211] RUCO Br. at 34:7-8.

[212] RUCO's assertion that the utility is made whole is also misleading. *Id.* at 34:12-18. While it is true that a subsequent expenditure of the $3 of HUFs will put the $3 back in rate base, Utility A will never recover the lost return on the $3. Moreover, if it has collected another $3 of HUF, it will face another $3 deduction if they are still sitting in the bank. Thus, the utility will never be made whole if Staff and RUCO prevail.

[213] *Id.* at 34:6-7.

neglect."[214] RUCO never identifies a single instance of such regulatory abuse, nor does RUCO explain how the Company's proposed HUF tariff makes this sort of evil more likely. Moreover, RUCO's armageddon scenario is predicated on the idea of "unrecorded CIAC."[215] There is no unrecorded CIAC. As RUCO's own witness testified, every dollar of HUF funds collected and expended are reported to the Commission on an annual basis.[216] Again, the Company simply wants to postpone recording HUFs as CIAC until they are spent on plant, not avoid recording the collection of the HUF all together, or the recording of the expenditure of the HUF on plant. As Staff and RUCO like to point out, it is always the utility's burden to keep its records in such a manner. Thus, while RUCO's "chase the CIAC" argument sounds catchy, it is simply a desperate scare tactic unsupported by any credible evidence.

DATED this 29th day of October, 2010.

FENNEMORE CRAIG, P.C.

By______________________________
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[214] *Id.* at 34:18 – 35:1.
[215] *Id.* at 35:13.
[216] Tr. at 572:17 – 573:1.

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By: Maria San Jose

Bella Vista Water Co., Inc.
Northern Sunrise Water Company Inc.
Southern Sunrise Water Company Inc.

W-02465A-09-0411, W-20453A-09-0412, W-20454A-09-0413,
W-02465A-09-0414, W-20453A-09-0414 and W-20454A-09-0414

October 29, 2010

REPLY BRIEF
EXHIBIT A

ARIZONA-AMERICAN WATER COMPANY - ANTHEM/AGUA FRIA WASTEWATER DISTRICT
Docket No. WS-01303A-06-0403
Test Year Ended December 9, 2005

Schedule GWB-9

OPERATING INCOME STATEMENT - TEST YEAR AND STAFF RECOMMENDED

LINE NO.	DESCRIPTION	[A] COMPANY TEST YEAR AS FILED	[B] STAFF TEST YEAR ADJUSTMENTS	[C] STAFF TEST YEAR AS ADJUSTED	[D] STAFF RECOMMENDED CHANGES	[E] STAFF RECOMMENDED
1						
2	Wastewater Revenues	$ 4,483,353	$ -	$4,483,353	$ 1,297,538	$ 5,780,891
3	Other Wastewater Revenues	1,652,448	-	1,652,448	-	1,652,448
4	Other	-	-	-	-	-
5	**Total Operating Revenues**	**$ 6,135,801**	**$ -**	**$6,135,801**	**$ 1,297,538**	**$ 7,433,339**
6						
7	Labor	$ 504,984	$ -	504,984	$ -	$ 504,984
8	Salaries & Wages - Officers, Directors	-	-	-	-	-
9	Employee Pension and Benefits	116,494	-	116,494	-	116,494
10	Purchased Wastewater Treatment	-	-	-	-	-
11	Waste Disposal	163,269	-	163,269	-	163,269
12	Fuel and Power	453,018	-	453,018	-	453,018
13	Fuel for Power Production	-	-	-	-	-
14	Chemicals	98,672	-	98,672	-	98,672
15	Materials & Supplies O & M	-	-	-	-	-
16	Management Fees	827,789	(130,115)	697,674	-	697,674
17	Customer Accounting	101,712	-	101,712	-	101,712
18	Rents	52,821	(1,070)	51,751	-	51,751
19	Gen'l Office Expense	60,685	(4,583)	56,102	-	56,102
20	Contractual Services - Testing	-	-	-	-	-
21	Contractual Services - Other	-	-	-	-	-
22	Rental Of Building/Real Property	-	-	-	-	-
23	Rental Of Equipment	-	-	-	-	-
24	Transportation Expenses	-	-	-	-	-
25	Insurance - Vehicle	-	-	-	-	-
26	Insurance - General Liability	-	-	-	-	-
27	Insurance - Workman's Compensation	-	-	-	-	-
28	Insurance - Other Than Group	92,795	(9,740)	83,055	-	83,055
29	Telephone	-	-	-	-	-
30	Postage	-	-	-	-	-
31	Maintenance	159,533	(655)	158,878	-	158,878
32	Training, Travel, and Meals	-	-	-	-	-
33	Dues	-	-	-	-	-
34	Regulatory Comm. Exp. - Rate Case	50,000	-	50,000	-	50,000
35	Miscellaneous	276,619	(6,475)	270,144	-	270,144
36	Depreciation & Amortization Expense	2,496,417	(128,529)	2,367,888	-	2,367,888
37	Taxes Other Than Income	52,515	-	52,515	-	52,515
38	Property Taxes	348,574	(41,028)	307,546	21,293	328,839
39	Income Tax	(237,148)	231,746	(5,402)	488,052	482,650
40	Bad Debt Expense	-	-	-		
41	**Total Operating Expenses**	5,618,749	(90,450)	5,528,299	509,345	6,037,644
42	**Operating Income (Loss)**	$ 517,052	$ 90,450	$ 607,502	$ 788,193	$ 1,395,695

References:
Column (A): Company Schedule C-1
Column (B): Schedule GWB 10
Column (C): Column (A) + Column (B)
Column (D): Schedules GWB 2, Lines 29 and 37
Column (E): Column (C) + Column (D)

Bella Vista Water Co., Inc.
Northern Sunrise Water Company Inc.
Southern Sunrise Water Company Inc.

W-02465A-09-0411, W-20453A-09-0412, W-20454A-09-0413,
W-02465A-09-0414, W-20453A-09-0414 and W-20454A-09-0414

October 29, 2010

REPLY BRIEF
EXHIBIT B

Arizona American - Anthem/Aqua Fria Wastewater
Test Year Ended December 2005
Analysis of Revenues by Detailed Class

Exhibit
Schedule H-2

Rate Schedule	Description	Average Number of Customers	Total Number of Bills	Average Consumption	Total Consumption	Revenues: Present Rates	Revenues: Proposed Rates	Proposed Increase: Amount	Proposed Increase: %
E1MS1	General Sanitary Sewer Service Rate Residential - All	7,975	95,702	10,451	1,000,224,670	$3,386,814	$5,168,202	$1,781,388	52.60%
E2MS1	General Sanitary Sewer Service Rate Small Commercial - 5/8"	4	43	26,557	1,141,970	$1,730	$2,656	$926	53.52%
E2MS2	General Sanitary Sewer Service Rate Small Commercial - 3/4"	1	12	0	0	$366	$530	$164	44.93%
E2MS3	General Sanitary Sewer Service Rate Small Commercial - 1"	10	123	43,976	5,409,000	$9,591	$14,723	$5,132	53.51%
E2MS4	General Sanitary Sewer Service Rate Commercial Large User - All	55	661	92,021	60,826,000	$214,770	$341,721	$126,951	59.11%
E2M2	General Sanitary Sewer Service Rate Anthem/Aqua Fria Treatco - All	0	0	0	0	$0	$0	$0	0.00%
E4MS5	General Sanitary Sewer Service Rate Anthem/Aqua Fria Treatco - All	0	0	0	0	$0	$0	$0	0.00%
E4M2	General Sanitary Sewer Service Rate Anthem/Aqua Fria Treatco - All	0	0	0	0	$0	$0	$0	0.00%
E5M2	General Sanitary Sewer Service Rate Anthem/Aqua Fria Treatco - All	1	17	6,454,647	109,729,000	$254,571	$486,099	$231,528	90.95%
		8,047	96,558	6,627,653	1,177,330,640	$3,867,842	$6,013,931	$2,146,089	354.62%

	Average Number of Customers	Total Number of Bills	Average Consumption	Total Consumption	Present Rates	Proposed Rates	Amount	%
Total Unadjusted Revenues								
Residential	7,975	95,702	10,451	1,000,224,670	$3,386,814	$5,168,202	$1,781,388	52.60%
Commercial	70	839	162,554	67,376,970	$226,456	$359,630	$133,174	58.81%
Wholesale	1	17	6,454,647	109,729,000	$254,571	$486,099	$231,528	90.95%
Total Company	8,047	96,558	6,627,653	1,177,330,640	$3,867,842	$6,013,931	$2,146,089	55.49%
Residential					$312,196	$478,479		
Commercial					$23,471	$34,851		
Wholesale					$254,571	$486,099		
Total Adjusted Revenues								
Residential					$3,699,011	$5,646,680	$1,947,670	52.65%
Commercial					$249,927	$394,481	$144,553	57.84%
Wholesale					$509,143	$972,199	$463,056	90.95%
Total Company Including Test Year Adjustment / Customer Growth					$4,458,081	$7,013,360	$2,555,279	57.32%
Target Revenue Deficiency							$2,555,291	
Total Over / (Under) Recovery							($12)	0.00%

Supporting Schedules:
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