

OPEN MEETING ITEM



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GARY PIERCE - Chairman
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SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

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Executive Director

ARIZONA CORPORATION COMMISSION

2011 APR 12 P 1:50

AZ CORP COMMISSION
DOCKET CONTROL

DATE: - APRIL 12, 2011

DOCKET NOS.: W-01782A-10-0224 AND W-01782A-10-0465

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Yvette B. Kinsey. The recommendation has been filed in the form of an Opinion and Order on:

ABRA WATER COMPANY, INC.
(RATES/FINANCING)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00** p.m. on or before:

APRIL 21, 2011

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

APRIL 27, 2011 and APRIL 28, 2011

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602) 542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

Arizona Corporation Commission
DOCKETED

APR 12 2011

DOCKETED BY

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

1200 WEST WASHINGTON STREET, PHOENIX, ARIZONA 85007-2927 / 400 WEST CONGRESS STREET, TUCSON, ARIZONA 85701-1347
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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

GARY PIERCE - Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

IN THE MATTER OF THE APPLICATION
OF ABRA WATER COMPANY, INC. FOR
APPROVAL OF A RATE INCREASE.

DOCKET NO. W-01782A-10-0224

IN THE MATTER OF THE APPLICATION
OF ABRA WATER COMPANY, INC. FOR
APPROVAL OF FINANCING.

DOCKET NO. W-01782A-10-0465

DECISION NO. _____

OPINION AND ORDER

DATE OF HEARING: February 17, 2011
PLACE OF HEARING: Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE: Yvette B. Kinsey
APPEARANCES: Mr. Kevin Larson, President of Abra Water Company,
on behalf of Abra Water Company; and,
Ms. Bridget Humphrey, Staff Attorney, on behalf of the
Utilities Division of the Arizona Corporation
Commission.

BY THE COMMISSION:

FINDINGS OF FACT

A. Procedural History

1. On June 4, 2010, in Docket No. W-01782A-10-0224, Abra Water Company, Inc. ("Abra" or "Company") filed with the Arizona Corporation Commission ("Commission") an application for a permanent increase in its water rates and charges, using a test year ending December 31, 2009 ("Rate Docket"). Abra's rate application requests an increase in rates to generate an additional \$90,137.24 over total test year revenues. The Company's application states its unaudited test year results show an operating loss of \$30,528, and that the rate increase is needed due to inflation, compliance with Federal regulations, increased operating costs, and a decrease in customer base.

1 2. On June 30, 2010, the Commission's Utilities Division ("Staff") filed a Letter of
2 Deficiency stating that Abra's rate application had not met the sufficiency requirements as outlined in
3 the Arizona Administrative Code ("A.A.C.").

4 3. On July 16, 2010, Abra filed responses to Staff's Letter of Deficiency. The Company
5 also requested a waiver from A.A.C. R14-2-103 regarding proposed rate schedules to be filed for
6 Class "C" water utilities in a rate case.

7 4. On August 19, 2010, Staff filed a Letter of Sufficiency in the rate docket stating that
8 Abra's application had met the sufficiency requirements as outlined in A.A.C. R14-2-103 and that
9 Abra had been classified as a Class C utility.

10 5. On August 30, 2010, by Procedural Order, the rate case hearing was set to begin on
11 February 17, 2011, publication of the application was ordered, and filing deadlines were established.

12 6. On October 7, 2010, Abra filed a notice of certification and mailing and an affidavit of
13 publication showing that on September 26, 2010, notice of the rate application had been mailed to
14 each of Abra's customers, and that notice of the rate application had been published in *The Verde*
15 *Independent/Bugle*, a three times a week newspaper, in Abra's service area.

16 7. On November 15, 2010, in Docket No. W-01782A-10-0465, Abra filed an application
17 with the Commission requesting authorization to incur long-term debt, in the amount of \$75,000 for
18 the purchase of arsenic media ("Finance Docket").

19 8. On November 29, 2010, Staff filed its Notice of Filing Direct Testimony in the rate
20 docket.

21 9. On December 29, 2010, Abra filed Rebuttal Testimony in the rate docket requesting
22 that Staff make recommendation on the Company's proposed standpipe rate.

23 10. On January 19, 2011, Staff filed a Notice of Filing Surrebuttal Testimony in the rate
24 docket addressing the Company's standpipe issue.

25 11. On February 16, 2011, Staff issued its Staff Report in the finance docket and
26 recommended approval of Abra's request to incur long-term debt, in the amount of \$75,000, to
27 cover the cost of media replacement for Abra's arsenic system.

28

1 12. On February 17, 2011, a full evidentiary hearing on Abra's rate application was
2 convened before a duly authorized Administrative Law Judge of the Commission. Staff appeared
3 through counsel and presented evidence and testimony. Mr. Kevin Larson, President of Abra,
4 appeared on behalf of the Company and presented testimony. No members of the public appeared to
5 provide public comment. During the hearing, Staff testified, among other things, that as part of
6 Staff's rate case analysis, Staff took into account the revenues need to cover the cost of financing the
7 media replacement Abra has requested in its finance docket. Staff further testified that Staff's
8 recommended rates would generate sufficient revenues to cover the cost of financing the media
9 replacement requested by Abra in the finance docket.

10 13. On March 8, 2011, Staff filed a Notice of Filing Late-Filed Exhibit which contained
11 an updated Drinking Water Compliance Status Report dated February 18, 2011.

12 14. On March 21, 2011, by Procedural Order, the rate and finance dockets were
13 consolidated for purposes of resolving the issues in the consolidated dockets.

14 **B. Background**

15 15. Pursuant to authority granted by the Commission, Abra is an Arizona for profit, Class
16 C utility, engaged in the business of providing water service to approximately 630¹ residential
17 customers and one elementary school in the vicinity of Paulden, in Yavapai County, Arizona.

18 16. Abra's service area is located approximately 25 miles north of the Town of Prescott on
19 Highway 89 in Yavapai County.

20 17. Abra is currently operating under rates and charges authorized in Commission
21 Decision No. 65917 (May 16, 2003):

22 18. Abra's existing water system is comprised of one well, a 500 gallon per minute
23 ("GPM") arsenic treatment plant, two storage tanks, four booster pumps, and a distribution system
24 serving approximately 636 customers during the test year.²

25 19. According to Staff, Abra's one well was producing water with an arsenic level of 14
26 parts per billion ("ppb") prior to the installation of its arsenic treatment plant in 2008.³

27 ¹ At hearing, Rod Yarbrow, Secretary/Treasurer for Abra, testified that the Company currently has 615 residential
28 customers. (Tr. at 15)

² Staff's Exhibit S-3 at 1.

1 20. Post hearing, Staff submitted an updated Arizona Department of Environmental
2 Quality (“ADEQ”) Compliance Status Report (“Report”) for Abra’s water system.⁴

3 21. As of February 18, 2011, ADEQ reported that Abra’s water system has major
4 deficiencies related to its required monitoring and reporting.⁵ According to ADEQ’s Compliance
5 Status Report (“Report”), Abra failed to provide water samples for the third quarter of 2009 and the
6 second quarter 2010.⁶ The Report states that the average of the water sample results Abra provided
7 through the fourth quarter of 2010, shows that Abra’s water system has a maximum contaminant
8 level (“MCL”) of 21 parts per billion, which exceeds the federal limit.⁷

9 22. The Report states ADEQ is unable to determine whether Abra’s water system is
10 delivering water that meets water quality standards as required by the A.A.C.⁸

11 23. Staff’s post hearing filing states that Staff continues to recommend approval of Abra’s
12 rate application.

13 24. We find that any rates approved herein should be effective for all services on the first
14 day of the month after Abra files with Docket Control, as a compliance item in this docket, the
15 ADEQ documentation showing that there are no compliance deficiencies and that Abra is delivering
16 water that meets water quality standards as required by the A.A.C.

17 25. During the test year, Abra reported 54,768,000 gallons of water pumped and
18 50,628,000 gallons sold, resulting in a non account water loss of approximately 7.56 percent for the
19 test year. Staff recommends that non-account water loss not exceed 15 percent and should be 10
20 percent or less. Staff concluded that Abra’s non-account water loss is within acceptable limits.⁹

21 26. Based on the drop in the number of customers Abra serves, Staff concluded that Abra
22 will experience very little growth in the next three to five years and Abra’s water system has adequate
23 water production capacity and storage to serve its existing customers and reasonable growth.¹⁰

24
25 ³ Staff Exhibit S-3 at 1.

⁴ Staff’s late-filed exhibit dated March 8, 2011.

26 ⁵ ADEQ Status Report issued February 18, 2011.

⁶ Id.

27 ⁷ Effective January 23, 2006, the U. S. Environmental Protection Agency (“EPA”) enacted new rules reducing the MCL
for arsenic in drinking water from 50 ppb to 10 ppb.

⁸ ADEQ Status Report issued February 18, 2011.

28 ⁹ Staff’s Exhibit S-3 at 2.

¹⁰ Id. at 3.

1 27. Abra's service area is not located within any Active Management Area ("AMA") and
2 therefore is not subject to AMA report and conservation requirements. Arizona Department of Water
3 Resources ("ADWR") reported that Abra is currently in compliance with departmental requirements
4 governing water providers and/or community water systems.¹¹

5 28. The Utilities Division's Consumer Services Section reported that for the period
6 beginning January 1, 2007 through September 17, 2010, one complaint and six opinions were filed
7 opposing Abra's proposed rate increase.¹²

8 29. Abra is in good standing with the Commission's Corporation Division.¹³

9 30. Abra is currently not in compliance with the Arizona Department of Revenue
10 ("ADOR") regarding income and sales taxes.¹⁴ Abra testified that it hired an accountant to do the
11 Company's taxes and that the accountant set up an automatic withdrawal for the tax payments, but
12 that the payments were not made to ADOR.¹⁵ Abra testified that the Company was unaware, until it
13 filed the current rate application, that the accountant had not been making the required payments to
14 ADOR.¹⁶ Abra's witness testified that the Company's payments were delinquent by \$16,000.¹⁷
15 Abra's witness stated that Abra worked with ADOR and paid \$3,000 up front and that ADOR has
16 agreed to set up a payment schedule for the Company.¹⁸ Abra's witness testified that Abra is current
17 on the installment payments to ADOR and that Abra currently owes approximately \$6,000 in back
18 taxes.¹⁹

19 31. Abra has an approved Curtailment Plan and Back Flow Prevention Tariff on file with
20 the Commission.

21 **C. Rate Application**

22 32. Abra's rate application seeks a permanent rate increase of \$90,137 for total operating
23 revenues of \$321,721, a 38.92 percent increase over test year revenues of \$231,584.

24 _____
25 ¹¹ ADWR Compliance Report issued June 23, 2010.

¹² Staff Exhibit S-1 at 4.

¹³ Id.

¹⁴ Staff Exhibit S-1 at 4.

¹⁵ Tr. at 20.

¹⁶ Id.

¹⁷ Tr. at 21.

¹⁸ Id.

¹⁹ Id.

1 33. Staff agrees with the Company's test year revenues of \$231,584. Staff recommends
2 revenues of \$314,481, an \$82,897, or 35.80 percent increase over test year revenues of \$231,584.

3 34. The Company does not oppose Staff's recommended revenues.

4 35. Abra's current rates and charges, as proposed in its application, and as recommended
5 by Staff are as follows:

<u>MONTHLY USAGE CHARGES:</u>	<u>Present Rates</u>	<u>Company Proposed Rates</u>	<u>Staff Proposed Rates</u>
5/8" x 3/4" Meter	\$ 11.55	\$ 17.50	\$ 14.00
3/4" Meter	17.33	23.22	21.00
1" Meter	28.88	38.70	35.00
1-1/2" Meter	57.75	77.39	70.00
2" Meter	92.24	123.60	112.00
3" Meter	173.25	323.16	224.00
4" Meter	288.75	366.93	350.00
6" Meter	577.50	773.85	700.00
<u>COMMODITY RATES:</u> (Per 1,000 Gallons)			
<u>5/8" Meter</u>			
1 - 3,000 gallons	\$ 2.37	\$ 3.25	\$ 2.25
3,001 - 10,000 gallons	2.55	3.50	3.80
Over 10,000 gallons	2.76	3.75	6.00
<u>3/4" Meter</u>			
1 - 3,000 gallons	\$ 2.37	\$ 3.25	\$ 2.25
3,001 - 7,000 gallons	2.55	3.50	3.80
Over 7,000 gallons	2.76	3.75	6.00
<u>1" Meter</u>			
0 - 3,000 gallons	\$ 2.37	\$ 3.25	N/A
3,001 - 10,000 gallons	2.55	3.50	N/A
Over 10,000 gallons	2.76	3.75	N/A
1 - 15,000 gallons	N/A	N/A	\$ 3.80
Over 15,000 gallons	N/A	N/A	6.00
<u>1-1/2" Meter</u>			
1 - 3,000 gallons	\$ 2.37	\$ 3.25	N/A
3,001 - 10,000 gallons	2.55	3.50	N/A
Over 10,000 gallons	2.76	3.75	N/A
1 - 30,000 gallons	N/A	N/A	\$ 3.80
Over 30,000 gallons	N/A	N/A	6.00
<u>2" Meter</u>			
0 - 3,000 gallons	\$ 2.37	\$ 3.25	N/A
3,001 - 10,000 gallons	2.55	3.50	N/A
Over 10,000 gallons	2.76	3.75	N/A

1	1 – 45,000 gallons	N/A	N/A	\$ 3.80
2	Over 45,000 gallons	N/A	N/A	6.00
3	<u>3" Meter</u>			
3	1 – 3,000 gallons	\$ 2.37	\$ 3.25	N/A
4	3,001 – 10,000 gallons	2.55	3.50	N/A
4	Over 10,000 gallons	2.76	3.75	N/A
5	1 – 90,000 gallons	N/A	N/A	\$ 3.80
6	Over 90,000 gallons	N/A	N/A	6.00
7	<u>4" Meter</u>			
7	1 – 3,000 gallons	\$ 2.37	\$ 3.25	N/A
8	3,001 – 10,000 gallons	2.55	3.50	N/A
8	Over 10,000 gallons	2.76	3.75	N/A
9	1 – 145,000 gallons	N/A	N/A	\$ 3.80
9	Over 145,000 gallons	N/A	N/A	6.00
10	<u>6" Meter</u>			
11	1 – 3,000 gallons	\$ 2.37	\$ 3.25	N/A
11	3,001 – 10,000 gallons	2.55	3.50	N/A
12	Over 10,000 gallons	2.76	3.75	N/A
13	1 – 300,000 gallons	N/A	N/A	\$ 3.80
13	Over 300,000 gallons	N/A	N/A	6.00
14	STANDPIPE SERVICE: (Per 1,000 Gallons)	\$ 3.00	\$ 10.00	\$ 6.00

15 SERVICE LINE AND METER INSTALLATION CHARGES:
16 (Refundable Pursuant to A.A.C. R14-2-405)

	<u>Company Proposed Charges</u>				<u>Staff Proposed Charges</u>			
	<u>Current Charges</u>	<u>Service Line</u>	<u>Meter</u>	<u>Total</u>	<u>Service Line</u>	<u>Meter</u>	<u>Total</u>	
17								
18	5/8" x 3/4" Meter	\$ 425.00	\$ 475.00	\$ -	\$ 475.00	\$ 380.00	\$ 95.00	\$ 475.00
19	3/4" Meter	450.00	500.00	-	500.00	335.00	165.00	500.00
19	1" Meter	500.00	550.00	-	550.00	350.00	200.00	550.00
20	1-1/2" Meter	700.00	900.00	-	900.00	470.00	430.00	900.00
20	2" Meter	1,125.00	1,325.00	-	1,325.00	590.00	735.00	1,325.00
21	3" Meter	1,505.00	1,705.00	-	1,705.00	660.00	1,045.00	1,705.00
21	4" Meter	2,340.00	2,540.00	-	2,540.00	910.00	1,630.00	2,540.00
22	6" Meter	4,445.00	4,645.00	-	4,645.00	1,410.00	3,235.00	4,645.00

	<u>Present Charges</u>	<u>Company Proposed</u>	<u>Staff Proposed</u>
23	<u>SERVICE CHARGES:</u>		
23	Establishment	\$ 20.00	\$ 35.00
24	Establishment (After Hours)	30.00	45.00
24	Reconnection (Delinquent)	30.00	45.00
25	Reconnection (Delinquent) After Hours	30.00	50.00
25	Meter Test (If Correct)	30.00	45.00
26	Deposit (Residential Meter)	(a)	(a)
26	Deposit (Non-residential Meter)	(a)	(a)
27	Deposit Interest	*	*
27	Re-establishment (Within 12 Months)	None	**
28	Re-establishment (After Hours)	None	**

1	NSF Check	\$ 15.00	\$ 25.00	\$ 25.00
	Deferred Payment (Per Month)	1.50%	1.50%	1.50%
2	Meter Re-read (If Correct)	\$ 10.50	\$ 20.00	\$ 20.00
	Late Payment Charge (Per Month)	1.50%	\$5.00 + 1.50%	1.50%
3	Fire Sprinkler	N/A	N/A	(c)

4 * Per Commission Rule A.A.C. R14-2-403(B)(3).

5 ** Per Commission Rule A.A.C. R14-2-403(D)(1).

6 (a) Residential – two times the average bill. Non-residential – two and on-half times the average bill.
R14-2-403(B)(7)

7 (b) Minimum charge times number of months disconnected.

8 (c) 2 percent of the monthly minimum for a comparable size meter connection but not less than \$10 per month

9 In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use and franchise tax. R14-2-409(D)(5).

10 All advances and/or contributions are to include labor, materials, overheads and all applicable taxes. Cost to include labor, materials and parts, overheads and all applicable taxes.

11 **Rate Base**

12 36. Abra proposed a fair value rate base (“FVRB”) of \$496,949, which is the same as its
13 original cost rate base (“OCRB”).²⁰ Staff recommends a \$466,276 OCRB, a \$30,673 reduction in the
14 Company’s proposed \$496,949 rate base.²¹

15 37. Staff recommends, and the Company has accepted, Staff’s adjustments to Plant-in-
16 Service including removing \$145,002 of Water Treatment Equipment²² and reclassifying \$65,102
17 into Water Treatment Plant²³ and \$79,900 into Media for Arsenic Treatment.²⁴

18 38. Staff also recommends an increase in Accumulated Depreciation by \$30,673 from
19 Abra’s proposed \$502,485 to \$533,158, to reflect authorized depreciation rates for the intervening
20 years since Abra’s last rate case as well as accumulated depreciation on arsenic media.²⁵ The
21 Company does not oppose Staff’s recommended adjustments to Accumulated Depreciation.²⁶

22 39. Staff also recommends that Abra use Staff’s typical and customary depreciation rates
23 by individual National Association of Regulatory Utility Commissioners (“NARUC”) category on a
24 going forward basis.

25 _____
26 ²⁰ The Company did not present information for Reconstruction Cost New Rate Base.
²¹ Staff Schedule JCM-3.
²² Staff Schedule JCM-5.
27 ²³ Id.
²⁴ Id.
28 ²⁵ Staff Schedule JCM-6.
²⁶ Tr. at 13.

1 40. We adopt Staff's adjustments and find that Abra's FVRB is \$466,276.

2 Revenues

3 41. The Company proposed test year adjusted total revenues of \$231,584 for an operating
4 loss of \$30,528. Staff agrees with the Company's proposed test year adjusted revenues of \$231,584,
5 but Staff's analysis results in an operating loss of \$29,653.

6 42. Staff made adjustments to Abra's operating expenses to include an increase in
7 Depreciation Expense of \$16,669 for a total of \$52,776, over the Company's proposed amount of
8 \$36,107.²⁷ Staff presented testimony that the Company had recorded depreciation/amortization on
9 the Organization and Franchises accounts, which is not in accordance with NARUC Uniform
10 Systems of Accounts ("USOA").²⁸ Staff's recommended Depreciation Expense reflects Staff's
11 recommended plant depreciation amounts by account.²⁹ Staff made additional adjustments to Abra's
12 test year operating expenses by reclassifying \$1,164 from Office Supplies Expense to Miscellaneous
13 Expense to reflect credit card processing fees; decreasing Miscellaneous Expense by \$10,689 to
14 remove debt issuance costs associated with a Water Infrastructure Finance Authority ("WIFA") loan
15 that was misclassified; adjusting rate case expense to include \$7,500, annualized over three years at a
16 rate of \$2,500 per year;³⁰ decreasing Water Testing Expenses by \$145 to \$5,426 to reflect water
17 testing expenses on a going forward basis; increasing test year property taxes by \$2,378 to \$8,884 for
18 the test year to reflect a modified ADOR property tax methodology;³¹ and by reducing test year
19 income tax expense by \$11,538, to reflect application of statutory state and federal income tax rates
20 to Staff's adjusted taxable income.³²

21 43. The Company does not oppose Staff's recommended adjustments to test year
22 operating expenses. We adopt Staff's adjustments to test year operating expenses and find that test

23 ²⁷ Staff Schedule JCM-8 and 9.

24 ²⁸ Direct testimony of Juan C. Manrique at 8.

25 ²⁹ Id.

26 ³⁰ Staff Schedule JCM-8.

27 ³¹ Staff testified that the modified ADOR methodology is primarily dependent upon revenue inputs over a three year
28 period instead of using actual real estate tax assessment to determine test year property tax expense. Staff stated that it
used the gross revenue conversion factor ("GRCF") to calculate Abra's test year property tax expense. According to
Staff, the GRCF automatically adjusts property taxes for changes in revenue in the same way that income taxes are
adjusted for changes in operating income. Staff states the CRCF method accurately captures the property tax expense at
any authorized revenue level; allows for accurate calculation of property tax expense at the test year revenue level; and
allows for recovery of any additional property tax expense incurred due to any increase in authorized revenue. (Exhibit S-
1 at 12) See also, Staff Schedules JCM 2, 8, 14 and 15.

³² Staff Schedule JCM 8 and 9.

1 year revenues were \$231,584, test year adjusted operating expenses were \$261,237, for a test year
2 operating loss of \$29,653.

3 **Rate of Return**

4 44. Staff supports the Company's proposed overall capital structure consisting of 55.3
5 percent debt and 44.7 percent equity.³³

6 45. In its rate application, Abra proposed an overall rate of return ("ROR") of 8.66
7 percent.³⁴

8 46. Staff recommends, and the Company has accepted Staff's proposed 7.5 overall ROR.³⁵

9 47. Staff defines cost of equity capital as the "rate of return that investors expect to earn
10 on their investment in a business entity given the risk." Staff believes that the market determines an
11 entity's cost of equity.

12 48. Abra is not a publicly-traded company and therefore Staff could not directly estimate
13 Abra's cost of equity. Consequently, Staff compared Abra's capital structure to other similarly
14 situated water companies and used two market based models; the Discounted Cash Flow ("DCF")
15 and Capital Asset Pricing Model ("CAPM") to estimate Abra's cost of equity.

16 49. Staff analyzed the capital structure of six publicly traded water companies, which
17 included American States Water, California Water, Aqua America, Connecticut Water, Middlesex
18 Water and SJW Corp (hereinafter "sample water companies") and compared them to Abra's overall
19 capital structure.³⁶ Staff chose the sample water companies because they are publicly-traded and they
20 receive the majority of their earnings from regulated operations.³⁷ Staff's analysis also examined
21 Abra's financial risks compared to the sample water companies.

22 50. Staff used both the constant-growth DCF model and the multi-stage or non-constant
23 growth DCF model. Staff calculated the growth factor for the constant growth DCF model by
24 averaging historical and projected earnings per share, dividends per share, and sustainable growth
25 rate for the sample water companies. Staff determined the multi-stage DCF using projected future

26 _____
27 ³³ Staff Exhibit S-1 at 14.

³⁴ Applicant Exhibit A-1.

³⁵ Staff Exhibit S-2 at 2.

³⁶ Staff Exhibit S-2 at 12.

³⁷ Id.

1 dividends for each of the sample water companies (using near term and long-term) growth rates;
 2 calculating the cost of equity using the present value of the forecasted dividends to the current stock
 3 price for each of sample water companies; and averaging in the individual sample water companies
 4 cost of equity estimates.

5 51. Staff arrived at its overall DCF estimate of 9.4 percent by averaging the constant
 6 growth DCF (8.9 percent) and the multi-stage DCF (9.8 percent) estimates.³⁸

7 52. For its CAPM analysis, Staff used the same sample water companies as in its DCF
 8 analysis.³⁹ According to Staff, the CAPM is used to determine the prices of securities in a
 9 competitive market and the CAPM describes the relationship between a security's investment risk
 10 and its market rate of return.⁴⁰ Staff used the average of three intermediate-term U.S. Treasury
 11 securities spot rates in its historical market risk premium cost of equity estimates as well as the 30-
 12 year U.S. Treasury bond spot rate in its current market risk premium cost of equity estimation.⁴¹
 13 Using the average of the *Value Line* betas⁴² for the sample water companies as a proxy for Abra's
 14 beta, Staff determined an average beta for the sample water companies of 0.78.⁴³ Staff explained that
 15 a beta of less than 1.0 will be less volatile than the market and a beta of more than 1.0 will be more
 16 volatile than the market.⁴⁴

17 53. Staff's CAPM analysis using historical risk premium of the cost of equity for the
 18 sample water companies is 7.7 percent.⁴⁵ Staff's CAPM analysis using current market risk premium
 19 of the cost of equity for the sample water companies is 11.5 percent.⁴⁶ Averaging the historical
 20 market risk premium CAPM (7.7 percent) and the current market risk premium CAPM (11.5
 21 percent), Staff's overall CAPM estimate for the sample water companies is 9.6 percent.⁴⁷

22 ...

23 ...

24 _____
 25 ³⁸ Staff Exhibit S-2 at 25.

³⁹ Staff Exhibit S-2 at 26.

⁴⁰ Id. at 27.

⁴¹ Id.

⁴² Beta- measures effect business risk and financial risk have on a security's rate of return.

⁴³ Id. See also Staff Schedule JCM-7.

⁴⁴ Id.

⁴⁵ Id. at 29.

⁴⁶ Id.

⁴⁷ Id.

1 54. Staff averaged the DCF estimate (9.4 percent) and the CAPM estimate of (9.6 percent)
2 to determine average estimated cost of equity for the sample water companies of 9.5 percent.⁴⁸

3 55. Staff concluded that Abra's capital structure is more leveraged than the average
4 sample water companies and therefore stockholders bear more financial risk. Therefore, Staff
5 recommends an 80 basis point adjustment to reflect the additional financial risk associated with
6 Abra's capital structure for a recommended cost of equity of 10.3 percent.⁴⁹

7 56. Abra has three outstanding Water Infrastructure Finance Authority ("WIFA") loans in
8 the amount of \$10,642 at an interest rate of 10 percent; \$123,955 at an interest rate of 4.2 percent;
9 and \$224,029 at an interest rate of 5.6 percent. Staff determined Abra's cost of debt of 5.25 percent
10 based on analysis of the weighted average cost of debt for these three WIFA loans.⁵⁰

11 57. We adopt the Company's proposed and Staff's recommended capital structure
12 comprised of 55.3 percent debt and 44.7 percent equity. We also adopt Staff's recommendation of a
13 10.3 percent cost of equity and a 5.25 percent cost of debt, resulting in an overall ROR of 7.5 percent.

14 58. Based on our findings herein, we determine that Abra's revenues should increase by
15 \$82,897.

16 **Rate design**

17 59. Abra currently uses an inverted three-tier rate design with no gallons included in the
18 minimum monthly charge for 5/8 x 3/4-inch meters.⁵¹ All of Abra's residential customers use 5/8-
19 inch meters and the school has a 1-inch meter. Staff recommends the continued use of Abra's three-
20 tier rate design, but recommends a two-tier rate structure for all meters 1-inch and above.⁵²

21 60. Using a typical bill analysis for residential 5/8-inch meter customers, Abra's proposed
22 rates for a median usage of 5,109 gallons would increase rates by \$10.59 from \$24.04 to \$34.63, or
23 44.07 percent.⁵³ Staff's recommended rates for a median usage of 5,109 gallons would increase rates
24 by \$4.73 or 19.66 percent from \$24.04 to \$28.77.⁵⁴

25 _____
26 ⁴⁸ Id. at 32.

⁴⁹ Id.

⁵⁰ Staff Schedule JCM-10.

⁵¹ Applicant's Exhibit A-1.

⁵² Staff Exhibit S-1 at 15.

⁵³ Staff Schedule JCM-17.

⁵⁴ Id.

1 61. Although Staff agrees with the majority of the Company's proposed service charges,
2 Staff disagrees that the Company should charge a \$5.00 fixed charge plus a 1.5 percent per month
3 charge for late fee payment.⁵⁵ Further, Staff recommends that Abra separate charges for Service Line
4 and Meter Installation; and that Abra have on file with the Commission a tariff for private fire
5 sprinklers equal to 2 percent of the monthly minimum for a comparable size meter connection, but no
6 less than \$10 per month.⁵⁶

7 62. Abra's witness testified that Abra agrees with Staff's recommended rate design and
8 Staff's service charge recommendations.⁵⁷

9 63. Staff's recommended rate design will generate Staff's recommended revenue
10 requirement of \$314,481, approved herein, which is derived from \$291,842 metered water sales and
11 \$22,639 from other water revenues.⁵⁸

12 64. We adopt Staff's recommended rate design and Staff's recommended rates and service
13 charges, and service line and meter installation charges.

14 **D. Finance Application**

15 65. In the finance application, Abra seeks approval to obtain a \$75,000, three-year
16 amortizing loan to purchase new arsenic media for its existing arsenic system.⁵⁹ Abra's application
17 states that it is seeking financing from JP Morgan Chase Bank and National Bank of Arizona at an
18 interest rate not to exceed 6.0 percent annually.⁶⁰

19 66. Abra submitted estimates for the cost of the new arsenic media with its finance
20 application.⁶¹

21 67. Staff determined the Company's capital projects are appropriate and that the related
22 cost estimates are reasonable.⁶²

23 68. Staff determined that at the conclusion of the test year, Abra's operating cash flow was
24 insufficient to meet its proposed long-term debt obligation.⁶³

25 ⁵⁵ Staff Exhibit S-1 at 16.

26 ⁵⁶ Id. See also Staff Schedule JCM-16.

27 ⁵⁷ Tr. at 13.

28 ⁵⁸ Staff Exhibit S-1 at 17.

⁵⁹ Applicant's Finance Application at 1.

⁶⁰ Id.

⁶¹ Applicant's Finance Application.

⁶² Staff Report Finance Docket at 2.

1 69. Staff calculated a pro forma capital structure reflecting Staff's debt service on the
2 issuance of the \$75,000 loan and Staff's recommended revenue requirement and operating income
3 (discussed in the above rate section).⁶⁴ Staff's pro forma analysis showed that with Staff's
4 recommended revenues the DSC would be 1.49, and sufficient to cover Abra's debt obligation.⁶⁵

5 70. Staff concludes that Abra's proposed debt financing is within Abra's corporate
6 powers, is compatible with the public interest, and is consistent with sound financial practices.

7 71. Staff recommends that the Commission authorize Abra to incur a three-year
8 amortizing loan in an amount not to exceed \$75,000 at an interest rate not to exceed 6.0 percent per
9 annum, subject to the Commission authorizing sufficient revenues to meet Abra's debt service and
10 the associated loan covenants.

11 72. Staff further recommends that:

- 12 a. Any authorization to incur debt in this proceeding terminate as of December
13 12, 2012;
- 14 b. Abra receive authorization to engage in any transaction and to execute any
15 documents necessary to effectuate the authorizations granted herein; and
- 16 c. Abra file with Docket Control, as a compliance item in this matter, copies of
 the loan documents within 60 days of the execution of any financing
 transaction authorized herein.

17 73. Abra did not file objections to Staff's recommendations on the finance application.

18 74. We find Staff's recommendations on Abra's finance application reasonable and they
19 should be adopted.

20 75. Because an allowance for the property tax expense is included in Abra's rates and will
21 be collected from its customers, the Commission seeks assurances from Abra that any taxes
22 collected from ratepayers have been remitted to the appropriate taxing authority. It has come to the
23 Commission's attention that a number of water companies have been unwilling or unable to fulfill
24 their obligation to pay the taxes that were collected from ratepayers, some for as many as twenty
25

26 ⁶³ At the end of the test year, Abra had a capital structure of 2.5 percent short-term debt, 55.4 percent long-term debt, and
27 42.1 percent equity. Staff determined that Abra's debt service coverage ("DSC") at the end of the test year was 0.22.⁶³
According to Staff, a DSC greater than 1.0 indicates that the Company has sufficient cash flow to cover its debt
obligations and a DSC of less than 1.0 indicates debt service obligations cannot be met by cash generated from
operations, and that another source of funds is needed. Staff Report Finance Docket at 2.

28 ⁶⁴ Id.

⁶⁵ Staff Schedule JCM-1.

1 years. Its is reasonable, therefore, that as a preventive measure Abra shall annually file, as part of its
2 annual report, an affidavit with the Utilities Division attesting that the Company is current in paying
3 its property taxes in Arizona.

4 **CONCLUSIONS OF LAW**

5 1. Abra is a public service corporation within the meaning of article XV of the Arizona
6 Constitution and A.R.S. §§ 40-0250, 40-251, 40-301, and 40-303.

7 2. The Commission has jurisdiction over Abra and of the subject matter of the rate and
8 finance applications.

9 3. Notice of the rate and finance applications were given in accordance with the law.

10 4. The rates and charges authorized herein are just and reasonable and should be
11 approved.

12 5. The financing approved herein is for lawful purposes, within Abra's powers, is
13 compatible with the public interest, with sound financial practices, and with the proper performance
14 by Abra of service as a public service corporation, will not impair Abra's ability to perform that
15 service.

16 6. The financing approved herein is for the purposes stated in the financing application
17 and is reasonably necessary for those purposes, and such purposes are not, wholly or in part,
18 reasonably chargeable to operating expenses or to income.

19 7. Staff recommendations, a modified herein, are reasonable and should be adopted.

20 **ORDER**

21 IT IS THEREFORE ORDERED that Abra Water Company, Inc. shall file by April 30, 2011,
22 revised rate schedules setting forth the following rates and charges:

23 **MONTHLY USAGE CHARGES:**

24	5/8" x 3/4" Meter	\$ 14.00
	3/4" Meter	21.00
25	1" Meter	35.00
	1-1/2" Meter	70.00
26	2" Meter	112.00
	3" Meter	224.00
27	4" Meter	350.00
28	6" Meter	700.00

1 COMMODITY RATES:
 2 (Per 1,000 Gallons)

3	<u>5/8" Meter</u>		
	1 - 3,000 gallons	\$ 2.25	
	3,001 - 10,000 gallons	3.80	
4	Over 10,000 gallons	6.00	
5	<u>3/4" Meter</u>		
	1 - 3,000 gallons	\$ 2.25	
6	3,001 - 7,000 gallons	3.80	
	Over 7,000 gallons	6.00	
7	<u>1" Meter</u>		
8	1 - 15,000 gallons	\$ 3.80	
	Over 15,000 gallons	6.00	
9	<u>1-1/2" Meter</u>		
10	1 - 30,000 gallons	\$ 3.80	
	Over 30,000 gallons	6.00	
11	<u>2" Meter</u>		
12	1 - 45,000 gallons	\$ 3.80	
	Over 45,000 gallons	6.00	
13	<u>3" Meter</u>		
14	1 - 90,000 gallons	\$ 3.80	
	Over 90,000 gallons	6.00	
15	<u>4" Meter</u>		
16	1 - 145,000 gallons	\$ 3.80	
	Over 145,000 gallons	6.00	
17	<u>6" Meter</u>		
18	1 - 300,000 gallons	\$ 3.80	
	Over 300,000 gallons	6.00	
19	STANDPIPE SERVICE: (Per 1,000 Gallons)	\$ 6.00	

20 SERVICE LINE AND METER INSTALLATION CHARGES:
 21 (Refundable Pursuant to A.A.C. R14-2-405)

22		<u>Service Line</u>	<u>Meter</u>	<u>Total</u>
	5/8" x 3/4" Meter	\$ 380.00	\$ 95.00	\$ 475.00
23	3/4" Meter	335.00	165.00	500.00
	1" Meter	350.00	200.00	550.00
24	1-1/2" Meter	470.00	430.00	900.00
	2" Meter	590.00	735.00	1,325.00
25	3" Meter	660.00	1,045.00	1,705.00
	4" Meter	910.00	1630.00	2,540.00
26	6" Meter	1,410.00	3235.00	4,645.00

27 SERVICE CHARGES:

28	Establishment	\$ 30.00
	Establishment (After Hours)	40.00

1	Reconnection (Delinquent)	50.00
	Reconnection (Delinquent) After Hours	50.00
2	Meter Test (If Correct)	50.00
	Deposit (Residential Meter)	(a)
3	Deposit (Non-residential Meter)	(a)
	Deposit Interest	6.00%
4	Re-establishment (Within 12 Months)	(b)
	Re-establishment (After Hours)	(b)
5	NSF Check	\$25.00
	Deferred Payment (Per Month)	1.50%
6	Meter Re-read (If Correct)	\$20.00
	Late Payment Charge (Per Month)	1.50%
7	Fire Sprinkler	(c)

- 8 (a) Residential – two times the average bill. Non-residential – two and on-half times the average bill.
R14-2-403(B)(7)
- 9 (b) Minimum charge times the number of months disconnected.
- 10 (c) 2 percent of the monthly minimum for a comparable size meter connection but not less than \$10 per month
11 In addition to the collection of regular rates, the utility will collect from its customers a proportionate share
12 of any privilege, sales, use and franchise tax. R14-2-409(D)(5).
All advances and/or contributions are to include labor, materials, overheads and all applicable taxes. Cost
to include labor, materials and parts, overheads and all applicable taxes.

13 IT IS FURTHER ORDERED that the above rates and charges shall be effective for all
14 services on the first day of the month after Abra Water Company, Inc. files with Docket Control as a
15 compliance item in this docket, the Arizona Department of Environmental Quality documentation
16 showing that there are no compliance deficiencies and that the Company is delivering water that
17 meets water quality standards required by the Arizona Administrative Code, Title 18, Chapter 4.

18 IT IS FURTHER ORDERED that Abra Water Company, Inc. shall notify its customers of the
19 revised rates and charges authorized herein and their effective date, in a form acceptable to the
20 Commission’s Utilities Division Staff, by means of an insert in its next regular scheduled billing.

21 IT IS FURTHER ORDERED that in addition to collecting its regular rates and charges, Abra
22 Water Company, Inc. shall collect from its customers a proportionate share of any privilege, sales or
23 use tax as provided for in A.A.C. R14-2-409(D).

24 IT IS FURTHER ORDERED that Abra Water Company, Inc. shall maintain its records, on a
25 going forward basis, in accordance with the National Association of Regulatory Utility
26 Commissioners Uniform System of Accounts.

27 IT IS FURTHER ORDERED that Abra Water Company, Inc. shall file with the
28

1 Commission's Docket Control, as a compliance item in this docket, a document stating it is in
2 compliance with its record keeping in accordance with the National Association of Regulatory Utility
3 Commissioners Uniform System of Accounts within six (6) months of the effective date of this
4 Decision.

5 IT IS FURTHER ORDERED that Abra Water Company, Inc. is authorized to obtain a three-
6 year amortizing loan for an amount not to exceed \$75,000, with an interest rate not to exceed 6
7 percent per annum, to finance new arsenic media as described herein.

8 IT IS FURTHER ORDERED that Abra Water Company, Inc. is hereby authorized to engage
9 in any transactions and to execute any documents necessary to effectuate the financing authorizations
10 granted herein.

11 IT IS FURTHER ORDERED that such authority is expressly contingent upon Abra Water
12 Company Inc.'s use of the proceeds for the purposes set forth in its finance application.

13 IT IS FURTHER ORDERED that approval of the financing set forth herein does not
14 constitute or imply approval or disapproval by the Commission of any particular expenditure of the
15 proceeds derived thereby for purposes of establishing just and reasonable rates.

16 IT IS FURTHER ORDERED that Abra Water Company, Inc. shall file, within sixty (60) days
17 of obtaining the financing, with the Commission's Docket Control, as a compliance item in this
18 docket, copies of all executed documents setting forth the terms of the financing.

19 IT IS FURTHER ORDERED that the authorization for Abra Water Company, Inc. to incur
20 debt, as described herein, shall terminate on December 31, 2012.

21 IT IS FURTHER ORDERED that Abra Water Company, Inc. shall adopt and use Staff's
22 depreciation rates by individual National Association of Regulatory Utility Commissioners category
23 on a going-forward basis.

24 IT IS FURTHER ORDERED that Abra Water Company, Inc. shall annually file, as part of its
25 Annual Report, an affidavit with the Utilities Division attesting that the Company is current in paying
26 its property taxes in Arizona.

27 ...

28 ...

1 IT IS FURTHER ORDERED that Abra Water Company, Inc. shall annually file as a
2 compliance item in this docket, an affidavit with the Utilities Division attesting that the Company
3 continues to make its installment payments to the Arizona Department of Revenue and is current in
4 paying its sales taxes, until all sales taxes in arrears as of the date of this Decision are paid in full.

5 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

6 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

7
8
9 CHAIRMAN _____ COMMISSIONER

10
11 COMMISSIONER _____ COMMISSIONER _____ COMMISSIONER

12 IN WITNESS WHEREOF, I, ERNEST G. JOHNSON,
13 Executive Director of the Arizona Corporation Commission,
14 have hereunto set my hand and caused the official seal of the
15 Commission to be affixed at the Capitol, in the City of Phoenix,
16 this ____ day of _____, 2011.

17 _____
18 ERNEST G. JOHNSON
19 EXECUTIVE DIRECTOR

20 DISSENT _____

21 DISSENT _____

22 YBK:db

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24
25
26
27
28

1 SERVICE LIST FOR:

ABRA WATER COMPANY, INC.

2 DOCKET NOS.:

W-01782A-10-0224 AND W-01782A-10-0465

3 Kevin Larson, President
4 ABRA WATER COMPANY, INC.
5 P.O. Box 515
6 Paulden, AZ 86334

7 Janice Alward, Chief Counsel
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9 ARIZONA CORPORATION COMMISSION
10 1200 West Washington Street
11 Phoenix, Arizona 85007

12 Steven M. Olea, Director
13 Utilities Division
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15 1200 West Washington Street
16 Phoenix, Arizona 85007

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