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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF LITCHFIELD PARK SERVICE COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANTS AND PROPERTY AND FOR INCREASES IN ITS WASTEWATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	Docket No. SW-01428A-09-0103
IN THE MATTER OF THE APPLICATION OF LITCHFIELD PARK SERVICE COMPANY, 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-01427A-09-0104
IN THE MATTER OF THE APPLICATION OF LITCHFIELD PARK SERVICE COMPANY, AN ARIZONA CORPORATION, FOR AUTHORITY (1) TO ISSUE EVIDENCE OF INDEBTEDNESS IN AN AMOUNT NOT TO EXCEED $1,755,000 IN CONNECTION WITH (A) THE CONSTRUCTION OF TWO RECHARGE WELL INFRASTRUCTURE IMPROVEMENTS AND (2) TO ENCUMBER ITS REAL PROPERTY AND PLANT AS SECURITY FOR SUCH INDEBTEDNESS.	Docket No. W-01427A-09-0116
IN THE MATTER OF THE APPLICATION OF LITCHFIELD PARK SERVICE COMPANY, AN ARIZONA CORPORATION, FOR AUTHORITY (1) TO ISSUE EVIDENCE OF INDEBTEDNESS IN AN AMOUNT NOT TO EXCEED $1,170,000 IN CONNECTION WITH (A) THE CONSTRUCTION OF ONE 200 KW ROOF MOUNTED SOLAR GENERATOR INFRASTRUCTURE IMPROVEMENTS AND (2) TO ENCUMBER ITS REAL PROPERTY AND PLANT AS SECURITY FOR SUCH INDEBTEDNESS.	Docket No. W-01427A-09-0120

NOTICE OF FILING BRIEF - PHASE 2

The Residential Utility Consumer Office ("RUCO") hereby submits this Brief in the above-referenced matter.

A. INTRODUCTION

The remaining issue in dispute concerns the treatment of the Company's proposed hook-up fees ("HUF") which provides that HUF proceeds will not be recorded as contribution in aid of construction ("CIAC") until they are spent on corresponding plant – a break from the Commission's long standing practice of deducting CIAC from rate base when it is received.[1] The Commission often talks about the importance of consistency in its ratemaking decisions and how utilities and other interested stakeholders should be able to rely on the Commission's consistency when making their decisions. The Commission has also embraced the principle of gradualism – the idea that regulatory change, if it is to occur, should happen gradually. The regulatory principle of gradualism, like the Commission's historical approach to booking CIAC are sound regulatory principles practiced by public utility commissions across the country on a daily basis.

The Commission's recent *Bella Vista* Decision[2] causes a conundrum. Why would Staff's Utilities Director change course at the Open Meeting in that case and reject his Staff's testimony and its long-held position regarding CIAC? More importantly, why would the Commission approve such a grave departure from its historical treatment of CIAC?

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[1] The parties agree with the Company's proposed surcharge for revenue foregone as a result of phased in rates approved in Phase I. The parties also agree to the active adult community hook-up fee proposed by Intervenor Pebble Creek Properties and adopted by the Company.

[2] *Bella Vista*, Docket No. W-02465A-09-041 et al., Decision No. 72251 dated April 7, 2011.

Since *Bella Vista*, Staff adopted its historical approach in the *Johnson Utilities'* rate case on June 1, 2011.[3] On June 6, 2011, the Commission's Staff filed testimony in this matter adopting the approach used in *Bella Vista*.[4] Is this consistency – hardly? In all of this there is no sense of gradualism, just confusion.

CIAC is CIAC and will always be CIAC. Trying to distinguish one type of CIAC from another or the timing of its accounting treatment is simply unwise and will lead to nothing, but confusion and inconsistent rate making. For this and many other reasons which will be discussed below, the Commission should treat CIAC as a reduction from rate base upon receipt without regard to when the CIAC is expended on plant.

B. HUF proceeds are CIAC.

HUF proceeds are CIAC under NARUC's Uniform System of Accounts ("USOA") for Class A Water Utilities:

> 271. <u>Contributions in Aid of Construction</u>
>
> A. This account shall include:
>
> 1. Any amount or item of money, services or property received by a utility, from any person or governmental agency, any portion of which is provided at no cost to the utility, which represents an addition or transfer to the capital of the utility, and which is utilized to offset the acquisition, improvement or construction costs of the utility's property, facilities, or equipment used to provide utility services to the public.[5]

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[3] See Exhibit R-3, Staff's Response to Petition to Amend Decision No. 71854, filed July 1, 2011 in *Johnson Utilities*, Docket Number WS-02987A-08-0180, Decision No. 71854 dated August 24, 2010

[4] See Exhibits S-1 and S-2, Direct Testimony of Marlin Scott and Jeffrey Michlik, respectively.

[5] See R-1 Direct Testimony of William Rigsby at 10.

The Company acknowledges that HUF proceeds are CIAC, but proposes they not be deducted from rate base un til expended on corresponding infrastructure. Neither the Commission Rules nor the NARUC USOA requires third party payments to be expended on infrastructure before being recorded as CIAC and deducted from rate base. The Commission's rule, A.A.C. R14-2-411.8 defines CIAC as "funds provided to the utility by the applicant under the terms of a main extension agreement and/or service connection tariff the value of which are not refundable." There is no condition precedent requiring third party funds to be expended on offsetting infrastructure prior to being deemed CIAC and deducted from rate base. Id. Based on NARUC and the Commission's rules, HUF proceeds are CIAC when received regardless of when expended.

C. NARUC USOA and the Commission's rules require CIAC be deducted from rate base.

Both the NARUC rule and the Commission's rule require CIAC to be deducted from rate base when received, not when expended. The NARUC Staff Subcommittee on Accounting and Finance defines CIAC as "payments made by customers generally to fund plant additions for new and expanded service" and requires CIAC to be deducted from rate base because it is a source of non-investor supplied capital.[6] Although Ms. Brown was very clear as to what NARUC USOA required, she acknowledged that each Commission addresses these issues as they deem fit. In Arizona, the Commission has adopted specific rules evidencing its preferred treatment which clearly requires test year CIAC to be

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[6] See Exhibit R-2 Surrebuttal Testimony of Crystal Brown ("Brown Test.") See also Transcript in *Bella Vista*, (BVT): 751, 753-757, citing to S-13 to Bella Vista Proceeding, NARUC Staff Subcommittee on Accounting and Finance.

deducted from rate base. A.A.C. R14-2-103B requires all utilities to calculate rate base consistent with schedule B-1. Schedule B-1 requires utilities to calculate total rate base by deducting test year CIAC from Net Utility Plant in Service (UPIS). *Id.* There is no provision in the Commission's rules allowing a delay or deferral of CIAC deductions. Indeed, the Commission's rules define Original Cost Rate Base ("OCRB") as "an amount consisting of the depreciated original cost, prudently invested, of the property (<u>exclusive of contributions and /or advances in air of construction</u>) at the end of the test year, used or useful, plus a proper allowance for working capital and including all applicable pro forma adjustments" (emphasis added). See A.A.C. R14-2-103H. The Commission's definition of Reconstructed New Rate Base ("RCND") mirrors the definition of OCRB as it relates to exclusion of test year CIAC and AIAC from rate base. See A.A.C. R14-2-103N. There is no provision of the Commission's rules which would allow it to define or determine a utility's rate base without deducting test year CIAC. Test year CIAC is a deduction from net utility plant in service ("UPIS") regardless of when it is expended on corresponding plant. Consistent with its rules, and its approved system of accounts, the Commission should require that test year CIAC be reduced from rate base regardless of when the CIAC is expended on plant.

D. Approval of the Company's tariff is inconsistent with the long standing precedent of the Commission.

The Commission has historically rejected the Company's proposed methodology. In both the *UNS Gas* case (Decision No. 70011) and the *UNS Electric* case (Decision No. 70360),[7] the Commission rejected the same proposed methodology the Company is requesting here. In *H20, Inc.* the water utility requested the Commission delay deduction of

[7] *UNS Gas*, Docket No. G-04204A-06-0463; *UNS Electric*, Docket No. E-04204A-06-0783.

unexpended CIAC and AIAC from rate base pending inclusion of offsetting plant.[8] The Commission reaffirmed its prior rulings and required *H20, Inc.* to exclude unexpended advances from rate base. *Id.* The Commission stated that granting the utility's request would "confer special treatment that falls outside of the Commission's rules..."[9] Liberty has not advanced any compelling argument or factual distinction to warrant a departure from normal rate-making treatment. The Commission should not confer special treatment on Liberty Water in this case.

E. Approval of the Company's proposal will result in a poor public policy.

Approval of the tariff as the Company proposes will result in bad public policy. RUCO's witness, William Rigsby testified consistently with the long-held position of RUCO Staff and the Commission.[10] He supported his position with specific references to the testimony of Crystal Brown, Staff's witness in the *Bella Vista* case and the transcript of that proceeding.[11] In *Bella Vista*, Ms. Brown testified that failing to deduct CIAC upon receipt creates a definite problem for Staff, RUCO or even the Company to follow or "chase CIAC."[12] Ms. Brown also testified that if there was a turnover in the personnel of the Company or Staff, plant could be added without recognition of the unexpended CIAC, causing ratepayers to pay more money in rates because of the Company's failure to include the offsetting deduction or reduction to rate base. *Id.* Moreover, Ms. Brown testified that if Staff or RUCO are unable to successfully chase or follow the unrecorded

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[8] *H20 Inc.*, Docket No. W-02234A-07-0557, Decision No. 71414 at 5.
[9] *Id.* at 8.
[10] T: 66-126.
[11] T: 70-73.
[12] T: 74-79. See also BVT: 757-758.

CIAC, the Company would end up with the unjust benefit of earning a return on the assets that were paid for by others and ratepayers would essentially pay twice: once through the hook-up fee and again through rates. *Id.*

As Mr. Rigsby and Staff have consistently testified, accounting errors are a very real possibility. The change adopted in *Bella Vista* is far less structured in its application than the implementation of an adjustor mechanism – yet unbelievably, unlike the typical adjustor mechanism there are no safeguards which have been established by the Commission or the Company in its tariff. Despite the safeguards associated with the adjustor mechanism, the correct application and implementation of an adjustor mechanism is an on-going challenge. The Commission has recently dealt with an incident where a sophisticated water utility has overlooked collection under an approved adjuster mechanism for several years.[13] In *Johnson Utilities*, the utility's application of an approved CAGRD adjustor mechanism has caused much confusion for the parties and significant frustration for the Staff.[14] Given these circumstances and the absence of any safeguards, there is no question that the concerns of Ms. Brown and Mr. Rigsby may soon become a reality. It is not a question of if, but a when a utility misapplies the Commission's new policy. The stakes are too high and the risks too great for the Commission to endorse a policy which violates its rules and approved system of accounts.

F. Denial of the proposed tariff will not harm the Company.

Denial of the proposed tariff does not harm the Company. The Commission's Rules as well as NARUC USOA require the Company to record CIAC upon receipt and reduce

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[13] *Arizona-American Water Company – Paradise Valley Water,* Docket No. W-01303A-98-0507, Decision No. 72208 (March 3, 2011).

[14] *Johnson Utilities,* Docket No. WS-02987A-08-0180. Decision No. 71854 dated August 24, 2010.

rate base simultaneously without a corresponding entry in the PIS account. While rate base is reduced if there is no corresponding PIS entry, it is definitely not a "penalty" as claimed by the Company. The Company is ultimately made whole. When the Company uses the CIAC funds, it places the value of the plant acquired in its PIS account. Once the CIAC is fully amortized, the PIS will still have value and rate base will be higher than if CIAC and PIS were recorded simultaneously.[15] Any reduction in rate base the Company experiences up front will be recovered on the back end. It is simply a matter of timing.

G. The Company has the ability to control timing to avoid any negative impact.

The issue of when CIAC is deducted from rate base is only an issue during a rate case. The Company is in control of when it files its rate application. Because the Company controls the timing of its application, it can also time the application to avoid recording CIAC before offsetting plant is constructed. A clear example of the Company's power to control the timing can be seen in this case. Mr. Sorenson testified that the Company resolved a dispute with Westcor/Goodyear L.L.C and Globe Land Investors L.L.C. ("Westcor/Globe") in a parallel proceeding.[16] The resolution reached during the test year required Westcor/Globe to pay Liberty Water $4.84 million dollars for expansion of service of which approximately $700,000 was subject to refund. Instead of taking receipt of the funds due from Westcor/Globe during the test year, the Company had Westcor/Globe place the funds in an escrow account on November 3, 2008, approximately 30-days post-test year.[17] The Company admits it withdrew the funds from the escrow account on or about December 10, 2010, a few days after the Commission issued its order in Phase I.

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[15] T: 74-75.
[16] *Westcor/Globe v. LPSCO*, Complaint Docket No. SW-01428A-08-0234.
[17] R: 21-22.

The nonrefundable advances are CIAC, but were not deducted from rate base in the current rate case. The Company's actions clearly demonstrate it already has the ability to control the timing of its rate applications with receipt of CIAC and plant expenditures. The Company has no need for the proposed tariff language.

The Commission needs to weigh the wisdom of approving the Company's request. Liberty Water has already demonstrated itself to be capable of ensuring that CIAC is not deducted from rate base until offsetting plant is included in PIS. The Commission does not need to take an extraordinary action in contradiction to its rules and approved system of accounts to help the Company with a non-existent problem.

H. Conclusion

The Commission's rules and approved system of accounts require HUF proceeds be recorded as CIAC upon receipt without any condition precedent necessitating the funds be expended on plant. RUCO urges the Commission not to apply the accounting treatment of HUF from *Bella Vista* to this rate case. The *Bella Vista* approach violates the Commission's existing rules and approved system of accounts. Approving such an accounting approach confers special benefits on Liberty Water and is arbitrary, capricious and an abuse of discretion. RUCO believes the Commission should treat its decision in *Bella Vista* as a "test case" to see how Staff and the utility track the unrecorded hook-up fees. There is no harm in requiring Liberty Water to comply with the traditional accounting treatment required by the Commission's rules. A utility which books CIAC sooner gets the CIAC off its books quicker. The issue is a matter of timing and the Company has demonstrated the ability to avoid rate base deductions by controlling the timing of its rate application, the receipt of CIAC and the addition of offsetting plant. The Commission may include a HUF tariff, but without the language allowing the Company to delay recording or deducting test year CIAC from rate base. The Company has demonstrated no need for such special treatment.

RESPECTFULLY SUBMITTED this 9th day of August, 2011.

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