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8 **BEFORE THE ARIZONA CORPORATION COMMISSION**

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Arizona Corporation Commission

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16 **IN THE MATTER OF ORANGE**
17 **GROVE WATER COMPANY, INC.'S**
18 **APPLICATIONS FOR A PERMANENT**
19 **RATE INCREASE AND A FINANCING**
20 **APPROVAL.**

Docket Nos. W-02237A-11-0180
W-02237A-11-0084

**COMPANY COMMENTS RE
STAFF REPORT**

21 Orange Grove Water Company, Inc. ("Company") hereby files its comments
22 regarding Staff Report, which are set forth in Attachment 1.

23 RESPECTFULLY SUBMITTED this 19th day of August, 2011.

24 **MOYES SELLERS & HENDRICKS LTD.**

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27 Steve Wene
28 Attorneys for Company

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Original and 13 copies filed this
19th day of August, 2011, with:

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

Donnelly Herbert

ATTACHMENT I

Engineering Analysis

Plant Additions and Retirement Documentation

The Company disputes the claim that the Company has not maintained documentation supporting its plant additions since the last rate case. The Company provided support for every plant additions since the last rate case.

With respect to retirements, the trend analysis utilized to determine the cost of retirements is an accepted method which is commonly used by smaller utilities and often used by large utilities. The underlying reason for the negative accumulated depreciation for pumping equipment has turned negative is NOT the result of the use of a reverse trend analysis to determine the retirement cost, but rather that the pumping equipment is being replaced faster than the estimated useful life implied by the 5% composite depreciation (20 year life) employed prior to Decision 71110 (June 5, 2009) and the 12.5% (8 year life) employed after this decision. Orange Grove's pumping equipment has typically been replaced every 4-6 years. The sandy water conditions in the area increases the failure rate of pumps. The solution to correcting the negative accumulated depreciation situation for pumping equipment is to increase the depreciation rate to a rate that is more reflective of the Company's actual experience with respect to pumping equipment; perhaps on the order of 16.7% (6 year life) rather than the 12.5% employed in the instant case.

The Company also disputes Staff recommendation that if the determined cost of a retirement exceeds the accumulated depreciation balance for that plant account, that the cost be adjusted so that it does not exceed the accumulated depreciation balance. Such treatment is unwarranted and would deprive the Company of the full recovery of its investment. Further, it is inconsistent with NARUC accounting standards (Accounting Instruction No. 27 B (2)).

Rate Base

Plant-in-service

The Company does not object to increasing plant-in-service by \$397 for new meters.

Accumulated Depreciation

The Company does not object to increasing accumulated depreciation by \$17 which reflects Staff's plant-in-service adjustment.

Accumulated Amortization of Contributions-in-aid of Construction (CIAC).

The Company disagrees with Staff's adjustment of \$8,569 to increase accumulated amortization of CIAC from \$19,435 to \$28,004. Staff's amortization rate employed for 2009 and 2010 of 7.25% (See Staff Schedules CSB-2, page 4 of 4) is too high and should be reflective of the depreciation rate of the plant at issue. The CIAC balance arose due to expired refundable line extension agreements which funded distribution mains. Staff has been provided with copies of the line extension agreements along with the Advance-in-aid of Construction ("AIAC") and CIAC schedules from the prior rate case (Docket No. W-02121A-08-0455) supporting the CIAC balance. No previous rate case recognized the depreciation of the cost of the mains because the mains were added after the Company's 1983 rate case (cost added in 1984, 1987, and 1989). See Decision 53723 (1983). By the 2008 rate case (Decision 71110), these mains were fully depreciated. The corresponding depreciation rate for account 331 – Transmission and Distribution mains is 2.0%. Using this rate for 2009 and 2010 the accumulated amortization balance would be \$23,391.

Working Capital

The Company does not object to the inclusion of a working capital allowance using the formula method.

Operating Revenues

The Company and Staff are in agreement of the level of test year revenues of \$108,240.

Operating Expenses

Repairs and Maintenance

The Company does not object to the remove of \$395 from Repairs and Maintenance Expense or the normalization of the computer repair and hydrant repair expenses. However, the Company believes that Staff made an error in computing the level of repairs and maintenance expense. On Staff Schedule CSB-3, page 2 of 8, Staff used \$8,671.35 as the Company's proposed reduction to repairs and maintenance expense. However, the Company proposed amount is \$7,759, not \$8,671.35. This adjustment was for the capitalized repairs and Well #2 of \$7,566 and for the removal of maintenance costs for the Somerton house of \$193. See Company Proforma Adjustment 4. Correcting this error will increase repairs and maintenance expense by \$912 to \$9,443 instead of the \$8,531 computed by Staff.

Office Supplies and Expense

The Company does not disagree with Staff's proposed adjustment to reduce Office Supplies and Expense by \$250.

Contractual Services

The Company does not disagree with Staff's proposed adjustment to reduce Contractual Services Expense by \$308.

Water Testing

The Company does not disagree with Staff's proposed adjustment to increase Water Testing Expense by \$100.

Rate Case Expense

The Company strongly disagrees with Staff's reduction to Rate Case Expense. Essentially, Staff is arguing that a small water company should receive no more than \$4,000 to promulgate a rate case. Staff's proposal is obviously designed to severely limit a small company's ability to hire knowledgeable rate consultants, attorneys and engineers employed as necessary. As Staff knows well, without such consultants, small water companies will be virtually defenseless against Staff. Put another way, Staff is effectively proposing that small water companies be financially constrained so they have enter into a litigious process against Staff and their attorneys without the assistance of legal counsel or rate consultants. This would violate due process.

Staff's proposal would have a chilling affect on small water companies considering a rate case application. Like almost all small water company owners, Mrs. Day does not have the requisite regulatory accounting and attorney skill set necessary to conduct a rate case on her own. In fact, in the previous rate case, Mrs. Day testified to that fact. If a small water company cannot recoup its rate case expense needed to hire consultants to file a sufficient rate case, then the companies won't file rate cases.

Moreover, the Company disagrees with Staff's rationale for the adjustment as shown on Staff Schedule CSB-2, page 4 of 8, is flawed and misleading. First, the analysis contains at least one error. More specifically Staff lists the prior authorized rate case expense for Orange Grove Water Company (Docket No. W-02237A-08-0455) as zero. However, in that case Orange Grove was authorized an annual rate case expense of \$3,375 amortized over 4 years for a total of \$13,500. Second, the rate cases for which no rate case expense was requested should be eliminated from the analysis. This is because there may have been underlying reasons for not requesting rate case expense including

the fact that the utility did not know it could seek rate case expense (if outside experts were utilized), that the applications were prepared in-house and the costs were included in the proposed wages in the rate case, or its owners were large utilities and the costs were simply absorbed. For example, in the rate case for Groom Creek Water (Docket No. W-02466A-08-0488), DS Water (Docket No. W-04049A-08-0339), and Appaloosa Water (Docket No. W-03443-08-0313), various levels of wages and salaries were authorized. These rate cases were likely prepared in-house and thus the costs reflected in wages. In the rate case for Water Utility of Northern Scottsdale (Docket No. W-03270A-08-0225), no rate case expense was requested in all likelihood because this utility was owned by Global Water, one of the largest utilities in Arizona, and the costs of preparation were absorbed by Global Water in order to keep the requested increase at a minimum. Further, Global Water likely prepared the case in-house without the need to expert consultants. In the rate case for Bellemont Water (Docket No. W-02528A-09-0421), Granite Mountain (Docket No. W-02467A-09-0333), Christopher Creek (Docket No. W-020459A-0168), and Ehrenberg Improvement (Docket No. W-02273A-09-0296, et. al.), it does not appear that these utilities actually requested rate case expense but rather regulatory expenses that were incurred during the test year. Typically, expenses for a rate case are incurred after the end test year and there is no indication that these utilities actually sought inclusion of those costs.

While the Company does not agree that an analysis of prior cases should be the basis of setting allowable rate case expense (it should be case specific based upon the actual circumstances and the actual costs incurred), the following modified Staff analysis based upon addressing the criticism outlined above demonstrates that the requested annual rate case expense is fair and reasonable under the circumstances.

Total Rate Case Expense	No. Years Amortized	Staff	Annual Expense Case in which amortized RC expense was requested	Company	Docket No.
\$ -		\$ -		Appaloosa Water	W-03443A-08-0313
\$ -		\$ -		Fisher's Landing	WS-04047A-07-0708
\$ -		\$ -		Groom Creek Water	W-01865A-07-0385 & 07-0384
\$ 13,500	4	\$ -	\$ 3,375	Orange Grove 2007	W-02237A-08-0455
\$ -		\$ -		Walnut Creek Water	W-02466A-08-0486
\$ -		\$ -		Northern Scottsdale	W-03270A-08-0225
\$ -		\$ -		Ds Water	W-04049A-08-0339
\$ -		\$ -		Lagoon Estates	W-01825A-09-0345
\$ -		\$ -		Q Mtn Mobile Home	W-02518A-10-0227
Not Specified	Not Specified	\$ 54		Bellemont Water	W-02526A-09-0421
Not Specified	Not Specified	\$ 288		Granite Mountain	W-02467A-09-0333
Not Specified	Not Specified	\$ 600		Christopher Creek	W-20459A-08-0168
Not Specified	Not Specified	\$ 500		Ehrenberg Improvement	W-02273A-08-0251
\$ 3,000	5	\$ 600	\$ 600	Sonoita Water	W-20435A-09-0296 & 09-0298
Not Specified	Not Specified	\$ 1,000		Baca Float Water	WS-01678A-09-0376

Not Specified	Not Specified	\$ 1,545		Montezuma Rimrock	W-04254A-08-0361
\$ 7,500	4	\$ 1,875	\$1,875	Virgin Mountain	W-03551 A-09-0205
\$ 6,000	3	\$ 2,000	\$ 2,000	Mountain Glenn	W-03875A-08-0421
\$ 7,500	3	\$ 2,500	\$ 2,500	Little Park Water	W-02192-09-0531
\$ 10,000	3	\$ 3,333	\$ 3,333	Whitehorse Ranch	W-0416A-09-0471
Not Specified	Not Specified	\$ 5,000		Beaver Dam Water	W-03067A-08-0266
Average		\$ 919	\$ 2,281		
Median		\$ 288	\$ 2,250		

The average authorized rate case expense in case where the utility actually requested rate case expense is \$2,281. The Company is seeking annual rate case expense of \$1,875, less than the average. Regardless, the concept that rate case expense should be set by what another company requested during its rate case conducted four years ago is simply a flawed approach.

Finally, it should be noted that the Company was authorized rate case expense of \$13,500 in its prior case amortized over 4 years or \$3,375 per year (Decision 71110, June 5, 2009). By the time a decision is rendered by this Commission in the instant case, the Company will have only recovered about 2.5 years worth of this expense or about \$8,500 and will be forgoing the remaining unrecovered balance of \$5,000. Ironically, it was necessary for Orange Grove to file this rate case because of the need for an increase rate in order that it could afford to fund long-debt for the Commission ordered installation of a storage tank. Orange Grove finds itself being punished for doing so. This is patently unfair and unjust.

Depreciation Expense

The Company disagrees with Staff's proposed level of depreciation expense. Staff's amortization rate for CIAC is 9.08%. As discussed earlier, CIAC funded transmission and distribution mains. The depreciation rate for account 331 – Transmission and Distribution Mains of 2% should be utilized for the amortization rate. Correcting the amortization rate will bring the level of depreciation expense to \$5,364 compared to Staff proposed depreciation expense of \$3,992.

WIFA Debt Surcharge

The Company does not oppose Staff's concept for a finance surcharge. However, the surcharge mechanism must include all costs associated with the proposed WIFA loan. These costs include principal, interest, fees, and any required reserve, repair and replacement funds, as well as tax gross up for income taxes.

The reason for the tax gross up is simple. The surcharge will be treated as revenues and only the interest portion is tax deductible. Thus, the Company will not net enough cash flow to fund the loan payment. Staff does not include this income tax effect and this is clearly demonstrated by a review of Staff's suggested methodology (Schedule CSB-6, page 1-3) and a review of Staff's Financial Analysis (Schedule CSB- 7). In Column [C] of Schedule CSB-7 you will find that Staff includes the revenues from the surcharge and the interest expense, but ignores the income tax effect. Debt surcharges that have been approved by the Commission in the past have included a gross up for income taxes on the principle portion of the loan payment.

Operating Margin

The Company objects to Staff's 8.25% before debt surcharge, which should not factor into the equation because it is a direct pass through. The minimum operating margin should be 10%. The operating margin will be less than 12%, which is low for a Class D utility. Orange Grove is cash starved and has had problems paying its bills in a timely manner. The Company has delayed certain needed maintenance in the past until it could generate sufficient cash to pay for maintenance and capitalized repairs. A lack of adequate funding is adversely impacting the Company's ability to provide safe and reliable water service to its customers.

Rate Design

The Company disagrees with shifting the revenue increase to the higher tier commodity rates while leaving the monthly minimums and the first tier commodity rate alone. This approach is unbalanced and the shift in revenue recovery to the higher tier commodity rate. Consequently, the Company will likely not generate the proposed revenue requirement. In the last rate case (Decision 71110), the Commission authorized revenues of over \$120,000. After a full year of new rates, the Company generated less than \$109,000. So, clearly the rate design has impacted the Company's revenues to a fairly significant extent.

Miscellaneous Service Charges

The Company does not object to Staff's proposed miscellaneous service charges. However, the Company would like to request that with respect to the late charge of 1.5% per month on the outstanding bill that a minimum of \$5 be set. The Company has found that many customers fail to pay their bills on time and when the late charge is very small, customers have no incentive to pay on time and will delay payment as long as possible. The delays in payment can have a severe impact on the cash flows of the Company.

Other Recommendations by Staff

Best Management Practices (“BMPs”)

The Company objects to Staff’s recommendation to implement at least three BMPs. The state administrative procedure statutes prohibit the Commission from including BMP conditions unless there is a statute or rule specifically authorizing such a condition. See A.R.S. § 41-1001, *et seq.* (“Regulatory Bill of Rights”); A.R.S. § 41-1001.01(A)(7) and A.R.S. § 41-1030(B) (agency conditions must be specifically authorized by statute or rule); A.R.S. § 41-1001(11) (defining licensing); A.R.S. § 41-1001(10) (defining license to include an agency approval).

Accordingly, the Commission must adopt rules before implementing such a program. The Commission has not undertaken any rulemaking on this issue. Until the Commission follows state law and adopts rules regarding BMPs, based upon statutory authority, it should not be requiring companies to implement BMPs. This is especially true here because the BPM rules fall under the jurisdiction of the Arizona Department of Water Resources and that agency has determined that the Company does not have to adopt BMPs.

Back-up Generator Alternative

The Company appreciates Staff’s to implement a back-up generator alternative instead of a more costly storage tank. However, the Company is concerned about the 120 day requirement to have the generator installed. Alternatively, the Company suggests that it be required to file documentation demonstrating that the on-site generator project has been completed 90 days after WIFA loan is funded.