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BEFORE THE ARIZONA CORPORATION COMMISSION

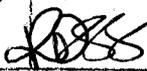
COMMISSIONERS

Arizona Corporation Commission

- GARY PIERCE - CHAIRMAN
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- PAUL NEWMAN
- BRENDA BURNS

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AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF
CHINO MEADOWS II WATER COMPANY
FOR A RATE INCREASE.

DOCKET NO. W-02370A-10-0519

**STAFF'S NOTICE OF FILING
SURREBUTTAL TESTIMONIES**

Staff of the Arizona Corporation Commission ("Staff") hereby files the Surrebuttal Testimonies of Juan C. Manrique, and Crystal S. Brown in the above-referenced matter.

RESPECTFULLY SUBMITTED this 19th day of September, 2011.


 Charles H. Hains
 Attorney, Legal Division
 Arizona Corporation Commission
 1200 West Washington Street
 Phoenix, Arizona 85007
 (602) 542-3402

Original and thirteen (13) copies of the foregoing filed this 19th day of September, 2011, with:

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

Copy of the foregoing mailed this 19th day of September, 2011, to:

Paul D. Levie, President
Matthew Lauterbach
CHINO MEADOWS II WATER CO.
2465 Shane Drive
Prescott, Arizona 86305



BEFORE THE ARIZONA CORPORATION COMMISSION

GARY PIERCE
Chairman

BOB STUMP
Commissioner

SANDRA D. KENNEDY
Commissioner

PAUL NEWMAN
Commissioner

BRENDA BURNS
Commissioner

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. W-02370A-10-0519
CHINO MEADOWS II WATER COMPANY, INC.)
FOR APPROVAL OF A RATE INCREASE)

SURREBUTTAL
TESTIMONY
OF
JUAN C. MANRIQUE
PUBLIC UTILITIES ANALYST I
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

SEPTEMBER 19, 2011

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EXECUTIVE SUMMARY
CHINO MEADOWS II WATER COMPANY, INC.
DOCKET NOS. W-02370A-10-0519

The Surrebuttal testimony of Staff witness Juan C. Manrique addresses the following issues:

Capital Structure – Staff continues to recommend that the Commission adopt a capital structure for Chino Meadows Water Company, Inc. (“Company”) for this proceeding consisting of 100.0 percent equity and 0.0 percent debt which is the Company’s actual capital structure.

Cost of Equity – Staff continues to recommend that the Commission adopt a 9.6 percent return on equity (“ROE”) for the Company. Staff’s estimated ROE for the Applicant is based on cost of equity estimates for the sample companies ranging from 9.2 percent for the discounted cash flow method (“DCF”) to 9.9 percent for the capital asset pricing model (“CAPM”). In its rebuttal, the Company agreed with Staff’s recommendation.

Cost of Debt – Chino Meadows’ capital structure contains no debt.

Overall Rate of Return – Staff recommends that the Commission adopt a 9.6 percent overall rate of return.

Mr. Jones’ Rebuttal – The Commission should reject the Company’s proposed use of an Operating Margin instead of a Cost of Capital calculation to determine revenues as this is an indirect request for compensation for firm-specific risk resulting in an excessive return on property devoted to public service.

1 **I. INTRODUCTION**

2 **Q. Please state your name, occupation, and business address.**

3 A. My name is Juan C. Manrique. I am a Public Utilities Analyst employed by the Arizona
4 Corporation Commission (“Commission”) in the Utilities Division (“Staff”). My business
5 address is 1200 West Washington Street, Phoenix, Arizona 85007.

6
7 **Q. Are you the same Juan C. Manrique who filed direct testimony in this case?**

8 A. Yes, I am.

9
10 **Q. What is the purpose of your Surrebuttal Testimony in this rate proceeding?**

11 A. The purpose of my Surrebuttal Testimony in this rate proceeding is to respond to the cost
12 of capital portion of the rebuttal testimony of Chino Meadows’ witness Mr. Ray L. Jones
13 (“Mr. Jones’ Rebuttal”).

14
15 **Q. Please explain how Staff’s Surrebuttal Testimony for cost of capital is organized.**

16 A. Staff’s surrebuttal testimony for cost of capital is presented in four sections. Section I is
17 this introduction. Section II discusses Staff’s cost of capital analysis. Section III presents
18 Staff’s comments on Mr. Jones’ rebuttal testimony. Lastly, Section IV presents Staff’s
19 recommendations.

20
21 **II. COST OF EQUITY AND OVERALL RATE OF RETURN**

22 **Q. Did Staff update its analysis concerning the Applicant’s cost of equity (“COE”) since
23 it filed its Direct Testimony?**

24 A. No. Staff did not update its analysis as the Company agreed with Staff’s COE
25 recommendation.

26

1 **Q. What is Staff's COE?**

2 A. Staff's COE is 9.6 percent, as it was in Staff's direct testimony.

3

4 **Q. What is Staff's updated overall ROR?**

5 A. Staff's overall ROR remains 9.6 percent as it was in Staff's direct testimony.

6

7 **III. RESPONSE TO THE REBUTTAL TESTIMONY OF THE APPLICANT'S COST**
8 **OF CAPITAL WITNESS**

9 **Mr. Jones' Rebuttal**

10 **Q. What is Staff's response to Mr. Jones' conclusion that the revenue requirement**
11 **should be determined by an operating margin as opposed to a cost of capital**
12 **calculation?¹**

13 A. Mr. Jones concludes that due to the Company's relatively small rate base, which leads to a
14 small operating income and a small margin over expenses, the Company may have
15 difficulty covering increasing or fluctuating costs, dealing with contingencies and
16 attracting new capital for system improvements. He also notes that determining the
17 operating income via the rate base rate of return method results in a lower operation
18 margin for the Company than for its sister company Granite Mountain Water Co., Inc.²

19

20 Use of the operating margin method for determining the operating income effectively
21 provides greater income for greater expenses relative to rate base. Variations in the
22 operating expenses to rate base ratio among utilities is a firm-specific risk for which no
23 additional compensation should be awarded. Staff agrees that for small utilities in
24 addition to rate of return on rate base, consideration should also be given to whether the
25 cash flows generated by the rate of return are sufficient to cover reasonable operating

¹ Mr. Jones' Rebuttal, page 4.

² Id.

1 contingencies. Under Staff's recommended revenue requirement, the Company would
2 generate annual cash flows of \$58,725 (\$19,813 operating income + \$38,912 depreciation
3 expense)³ which is a reasonable provision for contingencies. The Company is entitled to a
4 reasonable return on the value of its property and no more. Since the rate base rate of
5 return method provides adequate cash flows, the Company is not entitled to pick and
6 choose alternate methods to enrich its shareholders.

7
8 **IV. STAFF RECOMMENDATIONS**

9 **Q. What are Staff's recommendations for Chino Meadows' cost of capital?**

10 A. Staff makes the following recommendations for Chino Meadows' cost of capital:

- 11 1. Staff recommends a capital structure of 0.0 percent debt and 100.0 percent equity.
12 2. Staff recommends a cost of debt of not applicable or 0.0 percent.
13 3. Staff recommends a cost of equity of 9.6 percent.
14 4. Staff recommends an overall rate of return of 9.6 percent.

15
16 **Q. Does Staff's silence on any particular issue raised by the Company in its Rebuttal
17 testimony indicate that Staff agrees with the stated Rebuttal position?**

18 A. No.

19
20 **Q. Does this conclude your testimony?**

21 A. Yes, it does.

³ Crystal Brown Direct, Schedule CSB-10. Assumes no refunds on advances in aid of construction.

Chino Meadows II Water Company Cost of Capital Calculation
 Capital Structure
 And Weighted Average Cost of Capital
 Staff Recommended and Company Proposed

[A]	[B]	[C]	[D]
<u>Description</u>	<u>Weight (%)</u>	<u>Cost</u>	<u>Weighted Cost</u>
Staff Recommended Structure			
Debt	0.0%	0.0%	0.0%
Common Equity	100.0%	9.6%	9.6%
Weighted Average Cost of Capital			9.6%
Company Proposed Structure			
Debt	0.0%	0.0%	0.0%
Common Equity	100.0%	10.8%	10.8%
Weighted Average Cost of Capital			10.8%

[D] : [B] x [C]
 Supporting Schedules: JCM-3 and JCM-4.

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Chino Meadows II Water Company Cost of Capital Calculation
 Final Cost of Equity Estimates
 Sample Water Utilities

[A]	[B]	[C]	[D]	[E]
DCF Method				
Constant Growth DCF Estimate		$\frac{D_1}{P_0}^1$	+	α^2
Multi-Stage DCF Estimate		3.4%	+	5.1%
Average of DCF Estimates				k
				8.5%
				9.9%
				<u>9.2%</u>
CAPM Method				
Historical Market Risk Premium ³	Rf	β^5	x	(Rp)
Current Market Risk Premium ⁴	2.3%	0.76	x	7.2% ⁶
Average of CAPM Estimates	4.2%	0.76	x	10.2% ⁷
				k
				7.7%
				12.0%
				<u>9.9%</u>
			Average	9.6%
			Financial risk adjustment	
			Total	9.6%

1 MSN Money and Value Line

2 Schedule JCM-3

3 Risk-free rate (Rf) for 5, 7, and 10 year Treasury rates from the U.S. Treasury Department at www.ustreas.gov

4 Risk-free rate (Rf) for 30 Year Treasury bond rate from the U.S. Treasury Department at www.ustreas.gov

5 Value Line

6 Historical Market Risk Premium (Rp) calculated from Ibbotson Associates S&P 500 Yearbook data

7 Testimony

Chino Meadows II Water Company Cost of Capital Calculation
 Average Capital Structure of Sample Water Utilities

[A]	[B]	[C]	[D]
<u>Company</u>	<u>Debt</u>	<u>Common Equity</u>	<u>Total</u>
American States Water	49.8%	50.2%	100.0%
California Water	53.4%	46.6%	100.0%
Aqua America	57.2%	42.8%	100.0%
Connecticut Water	55.9%	44.1%	100.0%
Middlesex Water	49.4%	50.6%	100.0%
SJW Corp	<u>53.4%</u>	<u>46.6%</u>	<u>100.0%</u>
Average Sample Water Utilities	53.2%	46.8%	100.0%
Chino Meadows - Actual Capital Structure	0.0%	100.0%	100.0%

Source:

Sample Water Companies from Value Line

Chino Meadows II Water Company Cost of Capital Calculation
 Growth in Earnings and Dividends
 Sample Water Utilities

[A]	[B]	[C]	[D]	[E]
Company	Dividends Per Share 2000 to 2010 <u>DPS¹</u>	Dividends Per Share Projected <u>DPS¹</u>	Earnings Per Share 2000 to 2010 <u>EPS^{1,2}</u>	Earnings Per Share Projected <u>EPS¹</u>
American States Water	1.9%	3.7%	6.2%	2.2%
California Water	0.8%	3.0%	4.0%	4.0%
Aqua America	7.7%	6.0%	6.7%	8.4%
Connecticut Water	1.5%	No Projection	0.9%	No Projection
Middlesex Water	1.8%	No Projection	2.4%	No Projection
SJW Corp	<u>5.2%</u>	<u>3.8%</u>	<u>3.8%</u>	<u>9.1%</u>
Average Sample Water Utilities	3.2%	4.1%	4.4%	6.0%

¹ Value Line

² Negative values are inconsistent with the DCF, accordingly, they are excluded from the average.

Chino Meadows II Water Company Cost of Capital Calculation
Sustainable Growth
Sample Water Utilities

[A]	[B]	[C]	[D]	[E]	[F]
Company	Retention Growth 2001 to 2010 <u>br</u>	Retention Growth Projected <u>br</u>	Stock Financing Growth <u>vs</u>	Sustainable Growth 2001 to 2010 <u>br + vs</u>	Sustainable Growth Projected <u>br + vs</u>
American States Water	3.1%	6.7%	1.7%	4.9%	8.4%
California Water	2.2%	4.2%	3.7%	5.9%	7.9%
Aqua America	4.5%	5.5%	4.4%	8.9%	9.9%
Connecticut Water	2.3%	No Projection	0.9%	3.2%	No Projection
Middlesex Water	1.3%	No Projection	4.1%	5.4%	No Projection
SJW Corp	<u>3.9%</u>	<u>2.8%</u>	<u>0.1%</u>	<u>4.0%</u>	<u>2.9%</u>
Average Sample Water Utilities	2.9%	4.8%	2.5%	5.4%	7.3%

[B]: Value Line

[C]: Value Line

[D]: Value Line and MSN Money

[E]: [B]+[D]

[F]: [C]+[D]

Chino Meadows II Water Company Cost of Capital Calculation
 Selected Financial Data of Sample Water Utilities

[A]	[B]	[C]	[D]	[E]	[F]	[G]
Company	Symbol	Spot Price 6/22/2011	Book Value	Mkt To Book	Value Line Beta β	Raw Beta β_{raw}
American States Water	AWR	33.69	20.46	1.6	0.75	0.60
California Water	CWT	17.97	10.57	1.7	0.70	0.52
Aqua America	WTR	22.99	8.70	2.6	0.65	0.45
Connecticut Water	CTWS	25.24	12.82	2.0	0.80	0.67
Middlesex Water	MSEX	18.62	10.96	1.7	0.75	0.60
SJW Corp	SJW	22.80	14.66	1.6	0.90	0.82
Average				1.9	0.76	0.61

[C]: Msn Money

[D]: Value Line

[E]: [C] / [D]

[F]: Value Line

[G]: (-0.35 + [F]) / 0.67

Chino Meadows II Water Company Cost of Capital Calculation
 Calculation of Expected Infinite Annual Growth in Dividends
 Sample Water Utilities

[A]	[B]
<u>Description</u>	<u>g</u>
DPS Growth - Historical ¹	3.2%
DPS Growth - Projected ¹	4.1%
EPS Growth - Historical ¹	4.4%
EPS Growth - Projected ¹	6.0%
Sustainable Growth - Historical ²	5.4%
<u>Sustainable Growth - Projected²</u>	<u>7.3%</u>
Average	5.1%

¹ Schedule JCM-5

² Schedule JCM-6

Chino Meadows II Water Company Cost of Capital Calculation
 Multi-Stage DCF Estimates
 Sample Water Utilities

[A] Company	[B] Current Mkt. Price (P ₀) ¹ 6/22/2011	[C] d ₁	[D] d ₂	[E] d ₃	[F] d ₄	[H] Stage 2 growth ³ (g _n)	[I] Equity Cost Estimate (K) ⁴
American States Water	33.7	1.07	1.12	1.18	1.24	6.6%	9.6%
California Water	18.0	0.64	0.67	0.70	0.74	6.6%	10.0%
Aqua America	23.0	0.64	0.67	0.70	0.74	6.6%	9.2%
Connecticut Water	25.2	0.94	0.99	1.04	1.09	6.6%	10.2%
Middlesex Water	18.6	0.75	0.79	0.83	0.87	6.6%	10.5%
SJW Corp	22.8	0.72	0.75	0.79	0.83	6.6%	9.6%

Average **9.9%**

$$P_0 = \sum_{t=1}^n \frac{D_t}{(1+K)^t} + \frac{D_n(1+g_n)}{K-g_n} \left[\frac{1}{(1+K)} \right]^n$$

Where: P₀ = current stock price

D_t = dividends expected during stage 1

K = cost of equity

n = years of non-constant growth

D_n = dividend expected in year n

g_n = constant rate of growth expected after year n

1 [B] see Schedule JCM-7

2 Derived from Value Line Information

3 Average annual growth in GDP 1929 - 2010 in current dollars.

4 Internal Rate of Return of Projected Dividends

BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF)
CHINO MEADOWS II WATER COMPANY, INC.)
FOR A RATE INCREASE)
_____)

DOCKET NO. W-02370A-10-0519

SURREBUTTAL

TESTIMONY

OF

CRYSTAL S. BROWN

PUBLIC UTILITIES ANALYST V

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

SEPTEMBER 19, 2011

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EXECUTIVE SUMMARY
CHINO MEADOWS II WATER COMPANY
DOCKET NO. W-02370A-10-0519

Staff recommends total annual revenues of \$638,106 resulting in a \$162,624 operating income or 8.50 percent rate of return on a \$1,913,221 rate base. Staff's Surrebuttal testimony responds to Chino Meadows II Water Company ("Chino Meadows" or "Company") rebuttal testimony on the following issues:

1. Rate Base
 - a. Advances in Aid of Construction ("AIAC")
 - b. Amortization of AIAC
 - c. Post Test Year Plant

2. Operating Income
 - a. Salaries and Wages, Employees
 - b. Salaries and Wages, Officers, Directors, and Stockholders
 - c. Insurance, General Liability
 - d. Rate Case Expense
 - e. Miscellaneous Expense
 - f. Payroll Taxes
 - g. Leak Detection Expense
 - h. Interest on Customer Deposits

1 **INTRODUCTION**

2 **Q. Please state your name, occupation, and business address.**

3 A. My name is Crystal S. Brown. I am a Public Utilities Analyst V employed by the Arizona
4 Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff").
5 My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

6
7 **Q. Are you the same Crystal S. Brown who filed direct testimony in this case?**

8 A. Yes.

9
10 **PURPOSE OF SURREBUTTAL TESTIMONY**

11 **Q. What is the purpose of your surrebuttal testimony in this proceeding?**

12 A. The purpose of my surrebuttal testimony in this proceeding is to respond, on behalf of
13 Staff, to the rebuttal testimony of Mr. Ray Jones who represents Chino Meadows II Water
14 Company ("Chino Meadows" or "Company").

15
16 **Q. Did you attempt to address every issue raised by Chino Meadows in its rebuttal
17 testimony?**

18 A. No. I limited my discussion to certain issues as outlined below. My silence on any
19 particular issue raised in the Company's rebuttal testimony does not indicate that I agree
20 with the Company's stated rebuttal position on the issue. Rather, where I do not respond,
21 I rely on my direct testimony.

22
23 **Q. What issues will you address?**

24 A. I will address the issues listed below that are discussed in the rebuttal testimony of the
25 Company's witness Mr. Ray Jones.

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1. Rate Base
 - a. Advances in Aid of Construction ("AIAC")
 - b. Amortization of AIAC
 - c. Post Test Year Plant

2. Operating Income
 - a. Salaries and Wages, Employees
 - b. Salaries and Wages, Officers, Directors, and Stockholders
 - c. Insurance, General Liability
 - d. Rate Case Expense
 - e. Miscellaneous Expense
 - f. Payroll Taxes
 - g. Leak Detection Expense
 - h. Interest on Customer Deposits

SUMMARY OF RECOMMENDED REVENUES

- Q. Has Staff prepared schedules summarizing its recommended revenues and adjustments to rate base and operating income?**
- A. No, Staff has not.
- Q. Why has Staff not prepared schedules summarizing its recommended revenues and adjustments to rate base and operating income?**
- A. After Staff filed its direct testimony, the Company hired a consultant to prepare its rebuttal testimony. The consultant has raised new issues and proposed different treatment of some costs. Staff has requested documentation for these costs.
- Q. Will Staff file its schedules summarizing its recommended revenues and adjustments to rate base and operating income once it has received and reviewed all of the documentation?**
- A. Yes.

1 **RATE BASE**

2 *Rate Base Adjustment No. 1 – Advances In Aid of Construction (“AIAC”)*

3 **Q. Did Staff review Chino Meadows’ rebuttal testimony concerning AIAC?**

4 A. Yes.

5
6 **Q. What was the Company’s main concern?**

7 A. The Company’s main concern was that Staff did not reflect the Company’s payments on
8 the AIAC contracts.

9
10 **Q. Has Staff requested documentation for payments made on the AIAC contracts?**

11 A. Yes.

12
13 **Q. Will Staff adjust its recommended AIAC balance based upon the documentation
14 provided by the Company and file revised schedules if appropriate?**

15 A. Yes.

16
17 *Rate Base Adjustment Nos. 2 and 3– Contributions In Aid of Construction (“CIAC”) and
18 Amortization of CIAC*

19 **Q. Did Staff review Chino Meadows’ rebuttal testimony concerning CIAC and the
20 amortization of CIAC?**

21 A. Yes. As previously discussed in “Rate Base Adjustment No. 1 – AIAC,” the Company
22 states that it has made payments on the AIAC contracts that have converted to CIAC.
23 Staff has requested documentation for the payments on the AIAC contracts. The amount
24 of payments made on the AIAC contracts will reduce Staff’s recommended level of CIAC
25 and amortization of CIAC.
26

1 **Q. Will Staff adjust its recommended CIAC and amortization of CIAC balances based**
2 **upon the documentation provided by the Company and file revised schedules if**
3 **appropriate?**

4 A. Yes.

5

6 *Post-Test Year ("PTY") Plant*

7 **Q. Did Staff review Chino Meadows' rebuttal testimony concerning PTY Plant?**

8 A. Yes. The Company proposes to add \$3,500 in PTY plant.

9

10 **Q. Please describe the plant.**

11 A. The plant is computer software that will allow customers to pay their water bills with a
12 debit or a credit card.

13

14 **Q. Was the plant purchased for growth?**

15 A. No.

16

17 **Q. Is the plant revenue neutral?**

18 A. Yes. The Company is not requesting an additional charge for this service.

19

20 **Q. Has Staff requested invoices to support the plant cost?**

21 A. Yes.

22

23 **Q. Will Staff adjust its recommended plant balance based upon the documentation**
24 **provided by the Company and file revised schedules if appropriate?**

25 A. Yes.

26

1 **OPERATING INCOME**

2 *Operating Income Adjustment No. 1 – Salaries and Wages, Employees*

3 *Allocate \$19,563 in Employee Salary and Wage Expense to Regulated Affiliate*

4 **Q. Did Staff review Chino Meadows’ rebuttal testimony concerning the allocation of**
5 **\$19,563 to its regulated affiliate, Granite Mountain Water Company (“Granite**
6 **Mountain”)?**

7 A. Yes. The Company proposes to allocate \$5,248 which it maintains is the amount actually
8 incurred for Granite Mountain during the test year. The Company claims that the amount
9 was ascertained through time sheets.

10

11 **Q. Did Staff request information about the Company’s allocations and the basis of the**
12 **allocations?**

13 A. Yes. Staff issued data requests CSB 1-33 and CSB 4-9, both data requests sought
14 information about costs that were allocated and the basis of the allocations (e.g., time
15 sheets). Apparently, the Company collects the number of hours spent working for each
16 Company but does not use the information to appropriately allocate costs.

17

18 **Q. Did the Company discuss the use of timesheets in response to Staff’s data request**
19 **concerning allocations of costs and the basis of such allocations?**

20 A. No, it did not.

21

22 **Q. Assuming that \$5,248 was the actual salary and wage cost for Granite Mountain**
23 **during the test year, will Granite Mountain customers overpay for this cost?**

24 A. Yes, Granite Mountain customers would overpay by \$14,315. Assuming that Granite
25 Mountain customers incur approximately \$5,248 for salary and wage expense and given
26 that Decision No. 71869, dated August 31, 2010, authorized Granite Mountain customers

1 to pay, through rates, \$19,563 for salary and wage expense; an overpayment of \$14,315
2 would occur.

3
4 **Q. What is Staff's recommendation?**

5 A. Staff continues to recommend that \$19,563 be allocated to Granite Mountain.

6

7 *Remove \$10,400 Pro Forma Salary and Wage Increase*

8 **Q. Did Staff review Chino Meadows' rebuttal testimony concerning the \$10,400 pro**
9 **forma salary and wage increase?**

10 A. Yes, the Company claims that \$7,280 of the \$10,400 pro forma salary and wage increase
11 went into effect on January 1, 2011.

12

13 **Q. When will the Company have paid the full \$7,280 to its employees?**

14 A. The Company will have paid the full \$7,280 by December 31, 2011, two years after the
15 test year (i.e., December 31, 2009).

16

17 **Q. Did the Company provide canceled checks or similar documentation to provide**
18 **evidence of the increase?**

19 A. No, it did not.

20

21 **Q. What is Staff's recommendation concerning the \$10,400 pro forma salary and wage**
22 **increase adjustment?**

23 A. Staff continues to recommend decreasing employee salary and wage expense by \$10,400
24 to reflect Staff's disallowance of the pro forma adjustment.

25

1 *Remove Bonuses*

2 **Q. Did Staff review Chino Meadows' rebuttal testimony concerning the removal of**
3 **bonuses?**

4 A. Yes. The Company claims that "Without the bonus program, Chino would need to raise
5 base salaries to be competitive in the market and retain employees."

6

7 **Q. Does Staff agree?**

8 A. No. The Company has provided no studies or other type of documentation to show that
9 the removal of \$1,600 in total bonuses would cause a higher than normal turnover in
10 employees. Bonuses are an optional cost and, therefore, should be recognized below-the-
11 line (i.e., removed from rates).

12

13 **Q. What is Staff's recommendation regarding the bonuses?**

14 A. Staff continues to recommend decreasing salary and wage expense by \$1,600 to remove
15 the bonuses.

16

17 *Operating Income Adjustment No. 2 – Salaries and Wages, Officers, Directors, and Stockholders*

18 **Q. Did Staff review the Chino Meadows' rebuttal testimony concerning the \$35,498 in**
19 **salaries paid to the Company's owner?**

20 A. Yes, the Company maintains that the actual cost of \$35,498 should be included in salary
21 and wage expense because the amount is reasonable and prudent. Further the Company
22 states that "Staff has provided no evidence that the wage is unreasonable or otherwise
23 imprudent."

24

25 **Q. Is the burden of proof borne by the Company or Staff?**

26 A. The burden of proof is borne by the Company.

1 **Q. Did the Company provide any evidence to support the reasonableness and prudence**
2 **of the \$35,498?**

3 A. No, it did not. The Company did not provide any time studies and underlying
4 documentation nor did it provide time sheets for Mr. Levie.

5
6 **Q. Please review the number of businesses that Mr. Levie operates from the office**
7 **located at 2465 Shane Drive in Prescott, Arizona.**

8 A. According to data request CSB 4-7, Mr. Levie operates nine businesses. Those businesses
9 are: Chino Meadows, Granite Mountain, Antelope Lakes; City of Prescott.com, LLC;
10 Equestrian Constuction, LLC; Equestrian Development Corporation; LL&M Development
11 LLC; Levie-Antelope Lakes Development, Inc.; and Paul D. Levie, P.C.

12
13 **Q. Does Mr. Levie keep track of the number of hours per day spent working on each of**
14 **his nine businesses?**

15 A. No. Mr. Levie does not. Therefore, the Company cannot be certain that Mr. Levie spends
16 approximately 80 hours per month working only for Chino Meadows.

17
18 **Q. What is Staff's recommendation?**

19 A. Staff continues to recommend decreasing stockholder salary and wages expense by
20 \$4,879.

21

1 *Operating Income Adjustment No. 6 – Insurance, General Liability*

2 **Q. Did Staff review Chino Meadows’ rebuttal testimony concerning general liability**
3 **insurance expense?**

4 A. Yes, the Company states, “The Company feels that Staff’s use of Net Plant overly skews
5 the allocation to the much smaller Granite. This is due to the relatively new plant at
6 Granite Mountain with higher original cost and lower accumulated depreciation”.

7
8 **Q. Does Staff agree that the use of net plant overly skews the allocation to Granite**
9 **Mountain?**

10 A. No, Staff does not. Chino Meadow’s older plant will be replaced periodically with new
11 plant. Granite Mountain’s plant book value will decrease during the same time. When this
12 occurs, more of the insurance expense will be shifted to Chino Meadows. Thus, use of a
13 net plant allocation factor does not skew the cost but merely reflects book value of plant as
14 of the date it is calculated.

15
16 **Q. What is Staff’s recommendation?**

17 A. Staff continues to recommend decreasing general liability insurance by \$3,874.

18
19 *Operating Income Adjustment No. 8 – Rate Case Expense*

20 **Q. Did Staff review Chino Meadows’ rebuttal testimony concerning rate case expense?**

21 A. Yes, the Company states that it expects to incur rate case expense of at least \$30,000.

22
23 **Q. Has Staff requested invoices to support the rate case expense?**

24 A. Yes.

25

1 **Q. Will Staff adjust its recommended rate case expense based upon the documentation**
2 **provided by the Company and file revised schedules if appropriate?**

3 A. Yes.

4

5 *Operating Income Adjustment No. 9 – Miscellaneous Expense*

6 **Q. Did Staff review Chino Meadows’ rebuttal testimony concerning miscellaneous**
7 **expense?**

8 A. Yes, the Company continues to propose inclusion of costs for food and beverages in the
9 cost of service.

10

11 **Q. What rate-making treatment does Staff recommend for these types of expenses?**

12 A. Since these costs are not necessary to provide service, Staff continues to recommend that
13 they be recognized as non-operating expenses and recognized below the line (i.e. excluded
14 from the rates).

15

16 **Q. What is Staff’s recommendation?**

17 A. Staff continues to recommend the removal of costs for food, beverages, and similar costs
18 from the cost of service.

19

20 *Operating Income Adjustment No. 11 – Payroll Taxes*

21 **Q. Did Staff review Chino Meadows’ rebuttal testimony concerning payroll taxes?**

22 A. Yes. The payroll taxes are related to the Company’s pro forma salary and wage increase.

23

1 **Q. What is Staff's recommendation?**

2 A. Staff continues to recommend disallowance of the pro forma payroll tax expense in
3 accordance with Staff's recommended disallowance of the Company's pro forma salary
4 and wage increase.

5

6 *Operating Income Adjustment No. 4— Contract Services Testing, Leak Detection*

7 **Q. Did Staff review the Chino Meadows' rebuttal testimony concerning leak detection**
8 **expense?**

9 A. Yes, the Company continues to propose a pro forma adjustment in the amount of \$2,296
10 for leak detection.

11

12 **Q. Did the Company have inadequate service or fail to provide service during the test**
13 **year because it was unable to obtain leak detection services?**

14 A. No.

15

16 **Q. Has the Company incurred the cost for leak detection services?**

17 A. No, not as of September 2011, more than 20 months past the test year.

18

19 **Q. What is Staff's recommendation?**

20 A. Staff continues to recommend removing the pro forma adjustment for leak detection
21 services from the revenue requirement.

22

1 *Operating Income – Interest on Customer Deposits*

2 **Q. Did Staff review the Chino Meadows' rebuttal testimony concerning interest on**
3 **customer deposits?**

4 A. Yes, the Company is proposing to include interest on test year customer deposits that it
5 paid after the test year.

6

7 **Q. Has staff requested support for the payment?**

8 A. Yes.

9

10 **Q. Will Staff adjust its recommended interest on customer deposits based upon the**
11 **documentation provided by the Company and file revised schedules if appropriate?**

12 A. Yes.

13

14 **Q. Does this conclude Staff's surrebuttal testimony?**

15 A. No. Once Staff has received and reviewed all of the requested documentation, Staff will
16 file its surrebuttal schedules as soon thereafter as possible.