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MEMORANDUM

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Arizona Corporation Commission
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TO: Docket Control

FROM: Steven M. Olea
Director
Utilities Division

DATE: January 9, 2012

RE: SUPPLEMENTAL STAFF REPORT IN RESPONSE TO PROCEDURAL ORDER FOR HARRISBURG UTILITY COMPANY, INC.'S APPLICATION FOR A RATE INCREASE. DOCKET NO. W-02169A-11-0238

On December 9, 2011, the Administrative Law Judge issued a Procedural Order directing Staff to file, by January 9, 2012, a document addressing four issues. Pursuant to that Order, Staff hereby submits the attached Supplemental Staff Report. Staff continues to recommend adoption of the recommendations presented in its Staff Report issued October 14, 2011, without a hearing.

Any party who wishes may file comments to the Staff Report with the Commission's Docket Control by 4:00 p.m. on or before January 19, 2012.

EGJ:GLF:kdh

Originator: Gordon Fox

Service List for: Harrisburg Utility Company, Inc.
Docket No. W-02169A-11-0238

Mr. William Scott
Harrisburg Utility Company, Inc.
Post Office Box 905
Salome, Arizona 85348

SUPPLEMENTAL STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

HARRISBURG UTILITY COMPANY, INC.

DOCKET NO. W-02169A-11-0238

APPLICATION
FOR A RATE INCREASE

JANUARY 9, 2012

STAFF ACKNOWLEDGMENT

The Supplemental Staff Report for Harrisburg Utility Company, Inc., Docket No. W-02169A-11-0238, is the responsibility of the Staff members listed below.

Gordon L Fox

Gordon L Fox
Public Utilities Analyst Manager

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INTRODUCTION

Harrisburg Utility Company, Inc. ("Harrisburg" or "Company") is an investor-owned Arizona corporation and a class D certificated public service corporation providing water services to approximately 495 customers in Salome, in La Paz County, Arizona.

On June 10, 2011, the Company filed an application for a permanent rate increase. The application requests a 27.17 percent increase in operating revenue from $184,902 to $235,133 to provide a 33.39 percent rate of return on a $153,830 original cost rate base ("OCRB").[1]

On October 14, 2011, the Arizona Corporation Commission ("Commission") Utilities Division Staff "Staff" filed its Staff Report recommending rates that produce total operating revenue of $190,489, a $1,486 or 0.79 percent increase over test year revenue of $189,003, to provide a $20,456 operating income for an 11.25 percent rate of return on a $181,833 OCRB/FVRB.

On November 9, 2011, a Recommended Order was issued in this case, with an exception deadline of November 18, 2011. On November 18, 2011, Harrisburg filed a Memorandum stating that it had not received a copy of the Staff Report or Recommended Order and requested extending its deadline for filing exceptions to December 20, 2011. On December 7, 2011, Harrisburg filed a Memorandum responding to the Staff Report and Recommended Order, noting concerns regarding expense normalization adjustments, the revenue generated by Staff's recommended rates and Staff's recommended rate design. The Company also requested that the Commission reconsider Staff's recommended rates and grant a $2.00 increase, from $16.00 to $18.00, in the monthly minimum charge for 5/8 x 3/4-inch meters.

On December 9, 2011, the Administrative Law Judge issued a Procedural Order directing Staff to file, by January 9, 2012, a document addressing: (1) the Company's assertion that it did not receive a copy of the Staff Report;[2] (2) responding to the items of disagreement set forth in the Company's December 7, 2011, Memorandum; (3) providing any modifications to Staff's recommendations that Staff believes are appropriate; and (4) indicating whether Staff believes that a hearing should now be held in this matter.[3] These issues are addressed below.

STAFF ANALYSIS

Company Non-Receipt of Staff Report

All indications are that Staff mailed its Staff Report to the Company at the address listed in the service list. The Company presents this same address in its 2010 annual report filed with the Commission, as well as its filings made in this docket, including its December 7, 2011, Comments to the Staff Report. This is also the address listed in the Procedural Order issued in

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[1] The Company is not proposing a fair value rate base ("FVRB") that differs from the OCRB.
[2] The Procedural Order also directs the Company to file corrected contact information by December 30, 2011.
[3] The Procedural Order also directs Staff and the Company to file a response to the other party by January 30, 2012.

this case on September 23, 2011. The Company had not previously indicated any concern over receipt of documentation in this proceeding, e.g., data requests or the prior procedural order. Staff has no knowledge of a reason that the Company would not have received either the Staff Report or the Recommended Opinion and Order.

Items of Disagreement

Normalization of Operating Expenses

Normalization is the practice of recognizing an average on-going (i.e., normal) level of operating and maintenance expenses when the test year amount is abnormal. Staff typically performs a five-year historical analysis of operating and maintenance expenses to identify accounts that are potential expense normalization candidates. Multiple factors may influence whether a normalization adjustment is recommended. As noted in page 4 of the Staff Report, Staff normalized Repairs and Maintenance Expense due to the significant variance among years. The $24,091 test year expense exceeded the previous year expense by $10,004 ($14,091 - $14,087), or 71.0 percent. The test year amount is also $6,150, or 34.3 percent, greater than the highest level previously incurred for any year - $17,941 for 2007, three years prior to the test year. Moreover, Repairs and Maintenance Expense tends to vary over time for many utilities, and it is an expense over which a utility has significant ability to control by accelerating and deferring maintenance. There is no clear choice between using Staff's five-year normalization of $13,902 versus the Company's three-year normalization calculation of $14,607[4] in this instance.

The Company claims that normalizing Management Fees and Outside Services in the same manner (over five years) as Staff used for Repairs and Maintenance would have resulted in a $9,295 increase. Apparently, the Company is referring to the effect of normalizing the combined totals for Outside Services Expense and Salaries and Wages Expense.[5] It is less than obvious that the combination of these two expenses over each of the past five years represents the same purchase of services as is currently obtained only from Outside Services Expense. The Company currently has no Salaries and Wages Expense. Unlike the example of Repairs and Maintenance Expense discussed above, the Outside Services Expense has stabilized with $66,122 in the test year and $67,976 in the previous year, a $1,674 or 2.5 percent, difference. The Salaries and Wages Expense for both of those years is zero. The increase resulting from a five-year normalization of combined Outside Services Expense and Salaries and Wages Expense is due to a large amount ($98,489) recorded for Outside Services Expense in 2008, the year of transition away from the recording of Salaries and Wages Expense to Outside Services Expense. Transition costs are not on-going. Normalization adjustments should be reserved for abnormal test year amounts. Normalization adjustments should neither be universally applied nor applied to data-mined results.

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[4] Staff calculated $15,156 for the three-year amortization.

[5] Staff calculated a five-year normalization of $9,948 versus the Company's calculation of $9,295.

The Commission should reject the Company's proposal to increase the monthly usage charge for 5/8 x 3/4-inch meters by $2.00,[6] from $16.00 to $18.00, to support its normalization request for Management Fees and Outside Services.

Revenue Generated by Staff-Recommended Rates

The Company asserts that Staff's recommended rates overstate the actual revenue generated by the billing determinants by $623. Using a different program than was initially used to develop Staff's rates, Staff verified the accuracy of the revenues generated by its recommended rates. Consistent with Staff's normal practice, Staff's recommended rates generate a nominal surplus over the revenue requirement.

Rate Design

The Company's concern that Staff's rate design will produce less revenue due to part-year customers that represent customer billings without water consumption is without merit. Customers with no usage will continue to pay the monthly minimum charge. Consumption is not a factor for customer billings with no usage. The revenue anticipated from the commodity portion of rates is based on the test year consumption of customers that did have water consumption. Use by the redi-mix customer is based on test year consumption. No evidence shows that the test year is not representative of average on-going use.

STAFF RECOMMENDATIONS

Staff continues to recommend adoption of the recommendations presented in its Staff Report issued October 14, 2011.

Staff is not recommending a hearing; however, Staff is not opposed to a hearing if one is requested by the Company or deemed appropriate by the Administrative Law Judge.

[6] A $2.00 increase would generate $11,844 (5,922 annual billings x $2) in additional revenue.