

ORIGINAL



0000137722

RECEIVED

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

FENNEMORE CRAIG
Jay L. Shapiro (No. 014650)
3003 North Central Avenue, Suite 2600
Phoenix, Arizona 85012

2012 JUL -3 P 3:43
AZ CORP COMMISSION
DOCKET CONTROL

Attorneys for Pima Utility Company

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION
OF PIMA UTILITY 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-02199A-11-0329

IN THE MATTER OF THE APPLICATION
OF PIMA UTILITY 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-02199A-11-0330

PIMA UTILITY COMPANY

INITIAL CLOSING BRIEF

Arizona Corporation Commission
DOCKETED

July 3, 2012

JUL 0 8 2012

DOCKETED BY *AM*

TABLE OF CONTENTS

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

INTRODUCTION..... 1

OVERVIEW OF PIMA AND ITS REQUEST FOR RATE RELIEF..... 1

ANALYSIS OF DISPUTED ISSUES 5

I. Summary of Rate Base Recommendations..... 5

II. Rate Base Issues in Dispute 6

 A. Excess Capacity (Wastewater)..... 6

 1. Brief Statement of the Issue in Dispute 6

 B. Adjustment to AIAC/CIAC Balances 10

 1. Brief Statement of the Issue in Dispute 10

 2. Analysis and Argument 10

III. Income Statement–Operating Expenses in Dispute..... 11

 A. Salary and Wages (Water & Wastewater) 11

 1. Brief Statement of the Issue in Dispute 11

 2. Analysis and Argument 11

 B. Rate Case Expense 17

 1. Brief Statement of the Issues in Dispute..... 17

 2. Analysis and Argument 17

 C. Income Tax Expense..... 21

 1. Brief Statement of the Issue in Dispute 21

 2. Analysis and Argument 21

IV. Cost of Capital and Rate of Return 35

 A. Capital Structure and Cost of Debt 35

 B. Return on Equity 36

 1. Brief Statement of the Issue in Dispute 36

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

2. Analysis and Argument36

V. Rate Design and Other Tariff Changes43

A. Staff’s Rate Design Still Sends a Mixed Conservation Message44

 1. Brief Statement of the Issue in Dispute44

 2. Analysis and Argument44

B. RUCO’s Higher Effluent Commodity Rate is Unsupported45

 1. Brief Statement of the Issue in Dispute45

 2. Analysis and Argument45

C. Staff’s BMPS Are Unnecessary46

 1. Brief Statement of the Issue in Dispute46

 2. Analysis and Argument46

CONCLUSION47

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

TABLE OF ABBREVIATIONS AND CONVENTIONS

Pima Utility Company uses the following abbreviations in citing to the pre-filed testimony and hearing transcripts in this brief. Other documents that were admitted as exhibits during the hearing are cited by hearing exhibit number. The parties' final schedules setting forth their respective final positions will be cited in abbreviated format as follows: Company Final Schedule XXX, Staff Final Schedule XXX; RUCO Final Schedule XXX.* Other citations to testimony and documents are provided in full, including (where applicable) the Corporation Commission's docket number and filing date.

Other Abbreviations

Full term	Abbreviation
Pima Utility Company	Pima
Residential Utility Consumer Office	RUCO
Arizona Corporation Commission Staff	Staff
Administrative Law Judge	ALJ
Arizona Corporation Commission	ACC
Arizona Department of Environmental Quality	ADEQ
Arizona Department of Water Resources	ADWR
Best Management Practice	BMP
<i>Consolidated Water Utilities, Ltd.</i> , Docket Nos. E-1009-86-216, E-1009-86-217 & E-1009-86- 332	Consolidated Utilities
Capital Asset Pricing Model	CAPM
Discounted Cash Flow	DCF
Federal Energy Regulatory Commissions	FERC
Johnson Utilities Company	JUC
Line Extension Agreement	LXA
Millions of Gallons per Day	MGD
National Association of Regulatory Utility	NARUC

* Final schedules were filed on June 26, 2012.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

Other Abbreviations

Full term	Abbreviation
Commissioners	
Tucson Electric Power	TEP
Weighted Average Cost of Capital	WACC

Pima Pre-Filed Testimony

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Ray Jones Direct Testimony	A-1	Jones Dt.
Ray Jones Rebuttal Testimony	A-2	Jones Rb.
Ray Jones Rejoinder Testimony	A-3	Jones Rj.
Steven Soriano Direct Testimony	A-4	Soriano Dt.
Steven Soriano Rebuttal Testimony	A-5	Soriano Rb.
Thomas J. Bourassa Direct Testimony (Rate Base, Income Statement and Rate Design)	A-6	Bourassa Dt.
Thomas J. Bourassa Direct Testimony (Cost of Capital)	A-7	Bourassa COC Dt.
Thomas J. Bourassa Rebuttal Testimony (Rate Base, Income Statement and Rate Design)	A-8	Bourassa Rb.
Thomas J. Bourassa Rebuttal Testimony (Cost of Capital)	A-9	Bourassa COC Rb.
Thomas J. Bourassa Rejoinder Testimony (Rate Base, Income Statement and Rate Design)	A-10	Bourassa Rj.
Thomas J. Bourassa Rejoinder Testimony (Cost of Capital)	A-11	Bourassa COC Rj.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

Pima Pre-Filed Testimony

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Marc L. Spitzer Rebuttal Testimony	A-12	Spitzer Rb.
Marc L. Spitzer Rejoinder Testimony	A-13	Spitzer Rj.

Staff Pre-filed Testimony

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Darron Carlson Surrebuttal Testimony	S-4	Carlson Sb.
Crystal Brown Direct Testimony	S-5	Brown Dt.
Marlin Scott Jr. Direct Testimony	S-6	Scott Dt.
Marlin Scott Jr. Surrebuttal Testimony	S-7	Scott Sb.
John Cassidy Direct Testimony	S-8	Cassidy Dt.
John Cassidy Surrebuttal Testimony	S-9	Cassidy Sb.
Crystal Brown Surrebuttal Testimony	S-10	Brown Sb.

RUCO Pre-filed Testimony

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Robert B. Mease Direct Testimony	R-3	Mease Dt.
Robert B. Mease Surrebuttal Testimony	R-4	Mease Sb.
Timothy J. Coley Direct Testimony	R-5	Coley Dt.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

RUCO Pre-filed Testimony

Pre-Filed Testimony	Hearing Exhibit	Abbreviation
Timothy J. Coley Surrebuttal Testimony	R-6	Coley Sb.
William Rigsby Direct Testimony	R-9	Rigsby Dt.
William Rigsby Surrebuttal Testimony	R-10	Rigsby Sb.
William Rigsby Direct Testimony (Cost of Capital)	R-14	Rigsby COC Dt.

Other Portions of the Record

	Hearing Exhibit	Abbreviation
Pima Utility Company Ownership Schedule	A-14	
List of Board of Directors for Robson Affiliated Companies	A-15	
Bourassa Table A-1, Comparison Between C and S Corporations	A-16	
Excerpt of Poulos Direct Testimony from SW-02199A-98-0578	A-17	
Bourassa Table A-2, Further Comparison	A-18	
Data Request Response to CSB 1-12	S-1	
Decision No. 72498 (Las Quintas Serenas Water Company)	S-2	
Form S-4 Registration Statement for Meritage Homes	S-3	
Revised Rate Design for Sewer Division	S-11	

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

Other Portions of the Record

	Hearing Exhibit	Abbreviation
Data Request Response CSB 1-1 (General Ledger Excerpt)	R-1	
Data Request Response CSB 1-29, 5.2, 5.9	R-2	
Excerpt from BP West Coast Products v. FERC Decision (374 F.3d 1263 (D.C. Cir. 2004))	R-7	
Excerpt from ExxonMobil v. FERC Decision (487 F.3d 945 (D.C. Cir. 2007))	R-8	
Excerpts of Annual Reports of Various Companies	R-11	
Agreement relating to Extension of Water Distribution Facilities (between Pima Utility Company and Hancock-MTH Builders, Inc.	R-15	
Time Business Article re Taxes	R-16	
Pima's Notice of Filing Late Filed Exhibits (June 20, 2012)		Pima's Late Filed Exhibits
RUCO's Notice of Filing Revised Schedules (June 28, 2012)		RUCO Revised Schedules

7060086.4/075040.0025

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

INTRODUCTION

Pima Utility Company (“Pima” or the “Company”) hereby submits this Initial Closing Brief in support of its application for a rate increase for both its water and wastewater divisions.¹ Pima’s present rates and charges for water and wastewater utility service are based on test years ending December 31, 1992 and December 31, 1997, respectively. These rates are no longer sufficient to allow the Company to recover its operating expenses and earn a just and reasonable return on the fair value of its plant devoted to service. This is due to increases in various operating expenses coupled with the substantial investments in plant necessary to serve customers that Pima has made since the decisions for Pima’s last water rate case and wastewater rate case were issued in August 1994 and January 2000, respectively. As a consequence, the Company’s current rates of return for the Water Division and the Wastewater Division, based on adjusted test year data, are only 2.49 percent and 5.22 percent, respectively.²

OVERVIEW OF PIMA AND ITS REQUEST FOR RATE RELIEF

The Company is an integrated water and wastewater provider located in southeastern Maricopa County. Pima was formed in 1972 to provide water and wastewater services to the unincorporated master planned community of Sun Lakes.³ Sun Lakes was built in three phases between 1973 and 2008, and currently consists of approximately 10,000 homes with supporting neighborhood commercial development. During the test year, Pima served approximately 10,175 water connections and

¹ The key for conventions and abbreviations, as well as citations to a witness’ pre-filed testimony is set forth in the Table of Abbreviations and Conventions on pages iii to vii following the Table of Contents. The table also lists the hearing exhibit numbers of the parties’ pre-filed testimony. Other hearing exhibits are cited by the hearing exhibit number and, where applicable, by page number, e.g., Ex. A-1 at 2. The transcript of the hearing is cited by page number, e.g., Tr. at 1.

² Company Final Schedules A-1 (water) and A-1 (wastewater).

³ Soriano Dt. at 3:7-9.

1 10,051 wastewater connections.⁴ Pima's customer base is approximately 96 percent
2 residential customers, with only 196 commercial customers and 4 irrigation customers.⁵

3 Pima uses groundwater as its initial source of water supply.⁶ Using a system of
4 wells, storage facilities and booster stations, groundwater is distributed to residential and
5 commercial customers throughout the Company's service area. Pima then collects sewage
6 generated by its customers and treats the wastewater to at least B+ quality at Pima's
7 wastewater reclamation facility.⁷ The reclaimed effluent is recycled into the Sun Lakes
8 community through the use of Pima's reclaimed water distribution system installed in the
9 community. Pima delivers reclaimed (recycled) water to the Oakwood Golf Course for
10 direct use, and to five dual use recharge and recovery wells for recharge into the local
11 aquifer.⁸ Reclaimed effluent is recovered from the recharge and recovery wells for
12 delivery to landscaping and golf course uses in the Sun Lakes community. The
13 Company's fully integrated system directly reduces groundwater pumping by meeting turf
14 and landscaping demands with reclaimed water, and replenishes the aquifer by recharging
15 unused effluent.⁹ Pima also implements a water conservation program that meets all of
16 the requirements of ADWR.¹⁰ The Company's water loss is and has been under
17 10 percent for each of the last several years, including the test year.¹¹

18
19 _____
20 ⁴ Soriano Dt. at 3:9-11-18. In addition to Sun Lakes, Pima serves two subdivisions immediately adjacent
21 to Sun Lakes-Oakwood Hills and San Tan Vista. *Id.* The Company's certificated service area is almost
22 completely built out. Jones Dt. at 6:21; Scott Dt., Exhibit MSJ at 5, 19.

21 ⁵ Soriano Dt. at 3:18-20.

22 ⁶ Soriano Dt. at 4:8.

23 ⁷ Soriano Dt. at 4:8-12. The plant is permitted and designed to produce B+ effluent; however, it can
24 produce A+ effluent when it operates at less than design capacity. Jones Rj. at 5:22 – 6:18.

24 ⁸ Soriano Dt. at 4:12-16.

25 ⁹ Soriano Dt. at 4:16-21.

25 ¹⁰ Jones Dt. at 5:3-24.

26 ¹¹ Jones Dt. at 6:1-15.

1 Pima's present water rates were approved by the Commission in Decision
2 No. 58743 (August 11, 1994) and went into effect on or after September 1, 1994. Rates
3 and charges for wastewater utility service were approved by the Commission in Decision
4 No. 62184 (January 5, 2000) and went into effect on or after January 1, 2000. There have
5 been no other changes to the Company's water or wastewater rates since the current rates
6 went into effect. Meanwhile, Pima has addressed aging water infrastructure by
7 rehabilitating and rebuilding several facilities. Well 27, Water Plant #1 and Water
8 Plant #2 have been rehabilitated and rebuilt since the last rate water case.¹² The Company
9 also implemented a service line replacement program to address failing polyethylene
10 water services. To date, approximately 3,500 service lines have been replaced.¹³

11 Pima completed the final phase of fully integrating its water and wastewater system
12 in 1998. The final phase of system integration included construction of Phase 2 (.8 MGD
13 of wastewater treatment capacity), the water reclamation facility, four recharge/recovery
14 wells (RW-1, 2, 4 & 5) and some components of the reclaimed water distribution
15 system.¹⁴ Pima installed a fifth recharge/recovery well (RW-3) in 2008. Pima has also
16 made enhancements to the wastewater reclamation facility by upgrading the filter in 2000
17 and 2005, replacing the odor control system in 2005, and rebuilding the head works in
18 2008.¹⁵ The wastewater collection system has also received attention with nine lift
19 stations receiving major improvements or rehabilitation since the last wastewater rate
20 case.¹⁶

21

22

23 ¹² Jones Dt. at 6:23-25.

24 ¹³ Jones Dt. at 6:25 – 7:1.

25 ¹⁴ Jones Dt. at 7:5-8.

26 ¹⁵ Jones Dt. at 7:8-12.

¹⁶ Jones Dt. at 7:12-14.

1 Pima is a closely held corporation and operates in affiliation with several other
2 regulated utilities and Robson Communities Inc., which allows Pima to benefit from a
3 shared services model.¹⁷ At times during this rate case, Staff has appeared to be trying to
4 cast this affiliate relationship in a poor light.¹⁸ The Company doesn't really understand
5 such efforts. For starters, the utility and the developer, while affiliated, are separate legal
6 entities with different ownership.¹⁹ Moreover, there has been no evidence submitted nor
7 allegation made that affiliated transactions are disadvantageous to ratepayers.²⁰ In fact,
8 the opposite is true. Pima operates very efficiently as a member of the Robson family of
9 companies as reflected by its request for reasonable rate increases despite the significant
10 period of time between rate cases.²¹ The Company's operations are in compliance with all
11 applicable state and federal law and are virtually without complaints from customers over
12 the quality of service. In sum, at least in this case, operating a utility as a closely held
13 corporation in affiliation with the developer of the community results in high quality
14 utility service at reasonable rates.

15 The Company's applications for both its water and sewer divisions were filed on
16 August 29, 2011, seeking a finding of fair value rate base and setting of rates thereon for
17 both water and wastewater utility service. During the test year, Pima's adjusted gross
18 revenues were \$1,977,627 from water utility service and \$3,096,775 from wastewater
19 utility service.²² The adjusted operating income for the water division was \$227,440,
20

21 ¹⁷ Soriano Dt. at 1:11 – 2:4; Tr. at 402:20 – 405:20.

22 ¹⁸ See, e.g., Tr. at 39:23 – 40:1 (developer is essentially the water/sewer company). Tr. at 71:25 – 72:3
23 (questioning whether shareholders are friends or relatives of Mr. Robson); Tr. at 240:7-11, 242:4
(erroneously characterizing Pima as “a simple S Corp. with 40 family members”); Tr. at 399:14 – 400:22.

24 ¹⁹ See Tr. at 39:23 – 41:2.

25 ²⁰ Tr. at 107:9-10.

26 ²¹ Tr. at 404:9 – 405:20.

²² Company Final Schedules A-1 (water) and A-1 (wastewater).

1 leading to an operating income deficiency of \$528,830.²³ The adjusted operating income
2 from the wastewater division was \$516,143 leading to an operating income deficiency of
3 \$304,083.²⁴ Thus, the rate of return on the Company's water operations during the test
4 year was 2.49 percent, and the rate of return on the Company's wastewater operations
5 during the test year was 5.22 percent.²⁵

6 In its Final Schedules, the Company requests revenue requirements of \$2,717,184
7 from water utility service and \$3,522,034 from sewer utility service.²⁶ These proposed
8 revenue requirements are based on water and wastewater fair value rate bases equal to
9 \$9,122,677 and \$9,894,162, respectively, water and wastewater total operating expenses
10 of \$756,270 and \$820,226, respectively, and a WACC equal to 8.29 percent.²⁷ The
11 increases requested constitute increases of \$739,556 or 37.4 percent for water, and
12 \$425,259 13.73 percent for wastewater, over test year revenues.²⁸

13 ANALYSIS OF DISPUTED ISSUES

14 I. Summary of Rate Base Recommendations

15 As reflected in their respective Final Schedules, Pima's, Staff's and RUCO's
16 proposed rate bases for the water division are as follows:

17	<u>OCRB</u>	<u>FVRB</u>
18 Company	\$9,122,677	\$9,122,677
19 Staff	\$9,122,677	\$9,122,677
20 RUCO	\$9,122,679	\$9,122,679

21

22 ²³ Company Final Schedules A-1 (water) and A-1 (wastewater).

23 ²⁴ Company Final Schedules A-1 (water) and A-1 (wastewater).

24 ²⁵ Company Final Schedules A-1 (water) and A-1 (wastewater).

25 ²⁶ Company Final Schedules A-1 (water) and A-1 (wastewater).

26 ²⁷ Company Final Schedules A-1 (water) and A-1 (wastewater).

²⁸ Company Final Schedules A-1 (water) and A-1 (wastewater).

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

For the wastewater division, the rate bases proposed are as follows:

	<u>OCRB</u>	<u>FVRB</u>
Company	\$9,894,162	\$9,894,162
Staff	\$9,646,467	\$9,646,467
RUCO	\$9,881,940	\$9,881,940

The Company agrees that its original cost rate base should be used as its fair value rate base in this proceeding.

II. Rate Base Issues in Dispute

Prior to the start of the hearings, there were only two rate base issues in dispute. The first issue relates to dispute over excess capacity between the Company and Staff. The second issue involving AIAC refunds to a developer once thought to be bankrupt, appears to have been resolved during and immediately after trial. Both issues are addressed below.

A. Excess Capacity (Wastewater)

1. Brief Statement of the Issue in Dispute

Staff recommends plant in service be reduced by roughly \$600,000, the cost of the second phase of Pima’s wastewater treatment facility. Based on test year actual peak flows, Staff has determined that Phase 2 is “excess capacity.” But Staff’s narrow view overlooks important factors that make it clear that all of the plant, including Phase 2, is used and useful serving existing customers. Among other factors, the Company would not have and be serving more than 3,000 of its current connections without the second phase. Therefore, Phase 2 is currently used, useful and necessary for Pima to serve the Sun Lakes community.

2. Analysis and Argument

The Company’s treatment facility has a maximum capacity of 2.4 MGD.²⁹ The facility was built in two phases. The first phase included 1.6 MGD and was included in

²⁹ Scott Dt., Ex. MSJ at 18.

1 rate base in the last rate case for the sewer division.³⁰ In the second phase, .8 MGD came
2 on line in 1998, while that rate case was pending.³¹ Since that time, actual flows have
3 varied significantly and appear to have ranged from a high peak day of 2.2 MGD to a low
4 peak of 1.44 MGD during the test year.³² It is the latter number that Staff has seized on to
5 justify its recommended reduction to rate base. Staff's position, however, is undermined
6 by undisputed evidence showing that Staff's narrow and simplistic view of used and
7 useful does not work in this case.

8 First, the treatment facility was designed, permitted and constructed to serve
9 Pima's existing customers.³³ The Company's CC&N is built out and there is no
10 opportunity for expansion.³⁴ Because there is no growth expected, the usual concern over
11 "excess" capacity—intergenerational inequities—is absent.³⁵ In other words, the
12 customer connections being asked to pay for the plant are the same ones that were
13 supposed to and are using the plant today.³⁶ This clearly demonstrates that the entire plant
14 is necessary, used, and useful.

15 Second, the requirements for capacity were established by regulators ADEQ (and
16 Maricopa County), not the Company or developer.³⁷ In this case, those regulators actually
17 approved a lower per unit capacity than usually required based on historic flow data used
18 by Pima and the developer to size the current facility.³⁸ Nevertheless, the first 7,000

19 ³⁰ *Id.*

20 ³¹ Jones Dt. at 7:3-6; Tr. at 45:25 – 46:3.

21 ³² Jones Rb. at 7:18-22 (Table 1); Tr. at 33:9-12.

22 ³³ Tr. at 24 – 25. *See also* Tr. at 33:23 – 37:13; Jones Rb. at 10:1-6; Jones Rj. at 7:4 – 8:21.

23 ³⁴ Tr. at 30:10-16, 412:1-6.

24 ³⁵ Tr. at 37:1-13; Jones Rj. at 7:4 – 8:21.

25 ³⁶ Jones Rj. at 8:17-21. *See also* Tr. at 39:19-22. Notably, the projected build out of Sun Lakes was less
26 than 5 percent of the actual connections in Sun Lakes today. Tr. at 42:3 - 43:8.

27 ³⁷ Tr. at 34:1 – 35:18. *See also* Tr. at 423:18-25 (final decision on how much capacity is needed is up to
the regulators); Jones Rj. at 5:3-16.

28 ³⁸ Tr. at 34:13-18; Jones Rj. at 5:17-21.

1 homes still required 1.6 MGD of treatment capacity, Phase 1 of the plant.³⁹ In order to
2 expand the Sun Lakes community beyond that, additional treatment capacity was
3 required. This means that more than 3,000 homes exist in Sun Lakes today because
4 Phase 2 of Pima’s wastewater treatment facility was designed, permitted, and built.⁴⁰ Put
5 another way, the customers in Sun Lakes could not have obtained or received service
6 without the funding and construction of the Phase 2 plant—as ordered by ADEQ.

7 Third, the actual flows are subject to significant annual variation.⁴¹ Recently,
8 reduced flows have resulted from certain demographic changes. These changes include
9 higher levels of vacancy in Sun Lakes due to the downturn in the economy, more one-
10 occupant households at present, and more water conservation.⁴² Staff admitted that these
11 changes may not last and the flows may increase above test year levels at any time.⁴³ In
12 fact, flows during the year after the test year were higher than for the test year, with a
13 daily peak of nearly 1.52 MGD, almost 95 percent of the Phase 1 capacity of 1.6 MGD.⁴⁴

14 Fourth, in addition to allowing more than 3,000 connections to actually exist, there
15 are significant operational benefits to the capacity Staff deems “excess.” These benefits
16 include flexibility for maintenance and repair without disruption in service and reduced
17 staffing levels.⁴⁵ In addition, at current flow levels, Pima produces a “very high quality
18 effluent” reducing recharge and recovery costs and providing a direct benefit to the
19 irrigation customers.⁴⁶

20 _____
21 ³⁹ Tr. at 34:19 – 35:23.

22 ⁴⁰ Tr. at 34:19 – 35:23. *See also* Jones Rj. at 5:17-21.

23 ⁴¹ *See* Jones Rb. at 7:18-22 (Table 1); Tr. at 424:24 – 425:2.

24 ⁴² Tr. at 36:2-10. *See also* Tr. at 43:9-12.

25 ⁴³ Tr. at 425:3-5.

26 ⁴⁴ Jones Rb. at 7:18-22 (Table 1).

⁴⁵ Tr. at 39:3-13; Jones Rj. at 5:22 – 6:18.

⁴⁶ Jones Rj. at 5:22 – 6:18.

1 At trial, Staff agreed that Phase 2 was necessary for 3,000 homes to be built and
2 that those 3,000 homes are connected today.⁴⁷ Staff also agreed that actual peak flows in
3 each of the last six years exceeded 80 percent of the Phase 1 capacity.⁴⁸ In fact, as stated,
4 actual peak flows were greater than 90 percent of 1.6 MGD in 2011, and have exceeded
5 1.6 MGD in two of the past six years.⁴⁹ This means, if Pima had not had to build Phase 2
6 when it did, it would have had to have built it eventually under ADEQ requirements and
7 guidelines. This follows from what Mr. Scott called ADEQ's 80-90 rule under which
8 utilities are expected to be planning capacity when flows reach 80 percent, and building it
9 when flows reach 90 percent.⁵⁰ Both of those conditions were met here.

10 Despite all of these admissions, Staff asserts that the capacity is not used today
11 because the test year flows were below the 1.6 MGD capacity of Phase 1.⁵¹ This view is
12 simply not fair or reasonable under the circumstances. The Company was required to
13 build the plant in question in order for the homes connected to the plant today to be
14 constructed in the first place. Plant that a utility is required by regulators to build is
15 inherently necessary, used and useful. Once the customers a plant was intended to serve
16 are connected to that plant, there is no basis to consider a plant's capacity not used and
17 useful. Under Staff's reasoning, the millions of dollars of arsenic treatment facilities that
18 Arizona's water utilities had to build to comply with federal law would suddenly become
19 not used and not useful if the federal government changed the arsenic standard. Staff's
20 argument also would mean that a plant used to full capacity in one year could be rendered
21 not used and useful in later years by reduced demand. In this case, however, the Phase 2

22
23 ⁴⁷ Tr. at 415:6-13.

24 ⁴⁸ Tr. at 424:19-23.

25 ⁴⁹ Jones Rb. at 7:18-22 (Table 1); Scott Sb. at Figure 3.

26 ⁵⁰ Tr. at 424:7-18.

⁵¹ Tr. at 415:15-16.

1 plant was necessary under ADEQ guidelines, and it was used and is used to serve Pima's
2 customers.

3 Staff's reasoning must not be allowed to deprive the Company of a return on
4 prudent investment.⁵² The Company has to be ready to serve all the time under all sorts of
5 conditions, conditions that change for reasons outside the utility's control. Pima has done
6 that and the plant is used and useful.

7 **B. Adjustment to AIAC/CIAC Balances**

8 1. Brief Statement of the Issue in Dispute

9 The parties appear to be in agreement that the \$54,410.55 and \$38,367.15
10 refund payments recently made by Pima to Meritage for the water and
11 wastewater divisions, respectively, are known and measurable changes to
12 the test year. All of the parties have made the necessary adjustments in their
13 final schedules to reflect the impact of these payments.⁵³

14 2. Analysis and Argument

15 In 2004, Pima entered into water and wastewater LXAs with an entity known as
16 MTH-Hancock.⁵⁴ Because the Company believed that the developer went bankrupt and
17 was not aware of a successor, no refund payments were made.⁵⁵ During the rate case,
18 however, it was determined that MTH-Hancock did not go bankrupt; it merged into
19 Meritage Homes.⁵⁶ Pima has now paid the refunds that were due under the LXAs through
20 June 2011 and the developer has received those payments.⁵⁷ Refund payments reduce the

21 ⁵² Notably, the Commission's rule defining prudent investment directs the analysis to look at the
22 information available to the utility at the time the investment had to be made. A.A.C. R14-2-103(A)(3)(I).
23 Staff clearly did not do that in this case relying instead solely on test year data to reach its conclusion.

24 ⁵³ RUCO informed the Company that RUCO is in full agreement with the adjustment following the
25 payments to Meritage. After the Company notified RUCO of errors in the adjustment reflected in RUCO's
26 Final Schedules, RUCO filed Revised Schedules to address these errors.

⁵⁴ Exs. S-1 and R-15.

⁵⁵ *E.g.*, Moore Dt. at 8:9-23; Tr. at 110:17-18.

⁵⁶ Ex. S-3.

⁵⁷ *See* Pima's Late Filed Exhibits.

1 Company's AIAC balance and the Company has reflected those payments, at least
2 through the test year, in its final schedules.⁵⁸

3 Staff agrees that the payments to the developer constitute a known and measurable
4 change to the test year and has joined the Company in making the necessary adjustments
5 in its Final Schedules.⁵⁹ RUCO has joined in making the necessary adjustments as well.⁶⁰

6
7 **III. Income Statement—Operating Expenses in Dispute**

8 There are only three income statement or operating expense issues that appear to be
9 in material dispute in this rate case. These relate to one employee's salary, rate case
10 expense, and income tax recovery. Each is discussed in detail below.

11 **A. Salary and Wages (Water & Wastewater)**

12 **1. Brief Statement of the Issue in Dispute**

13 Both Staff and RUCO reject the Company's recommended salary level of
14 \$40,198 per division for Pima's chief executive officer in favor of
15 substantially lower expense levels. However, the recommendations of Staff
16 and RUCO are based on information known to be in error, and both
17 recommendations are otherwise unsupported by any substantial evidence in
18 the record. In contrast, the Company's recommended salary level is based
19 on substantial evidence, sound ratemaking and Commission precedent.
20 Thus, the Company, not Staff or RUCO, has met its burden of proof on this
21 issue.

22 **2. Analysis and Argument**

23 The Company proposes a total annual salary for its Chairman of the Board/CEO of
24 \$80,396 allocated equally between the two divisions.⁶¹ The Company determined this

25 ⁵⁸ Company Final Schedules B-2, page 5 (water) and B-2, page 5 (wastewater). Because the Company had
26 previously agreed to convert the AIAC to CIAC, its final adjustment is a little more complicated than the
simple reduction to AIAC Staff made. The Company's adjustment to reflect the refund payments made to
Meritage is explained in the Company's late filed exhibit. Pima's Late Filed Exhibits at Exhibit 4.

⁵⁹ Tr. at 462:1-20; Staff Final Schedules CSB-2 (water) and CSB-2 (wastewater).

⁶⁰ RUCO Final Schedule RBM-3; RUCO Revised Schedules at TCJ-3.

⁶¹ Company Final Schedules C-2, page 2 (water) and C-2, page 2 (wastewater).

1 number by taking the authorized salary level for this position from the last rate case
2 (decided in 2000) and grossing it up for inflation and customer number.⁶² This is a
3 reasonable means of determining a salary level for ratemaking purposes.⁶³ And the
4 Company's recommended salary level is in line with the salaries of similar executives at
5 comparable utilities and is reasonable under the circumstances presented in this case.⁶⁴

6 As discussed above, Pima serves more than 10,000 water and 10,000 sewer
7 customers.⁶⁵ Pima has over \$35 million of plant in service and generates gross revenues
8 of \$5.1 million annually.⁶⁶ As the senior executive, Mr. Robson is responsible for
9 corporate policy and direction on a daily basis. He meets regularly with Company
10 management to address short- and long-term business matters including review and
11 approval of capital improvements and financing, and approval of all salaries and wages.⁶⁷
12 Mr. Robson ensures that Pima meets all legal and regulatory requirements and maintains
13 the program quality and organizational structure necessary to operate a well-run utility.⁶⁸
14 Pima is a well-run utility, operating in full compliance with applicable law and its
15 efficiencies have resulted in consistently low rates.⁶⁹ In this way, customers benefit from
16 Mr. Robson's employment by Pima at a reasonable salary. The Commission recognized
17 this benefit before for ratemaking purposes.⁷⁰ Mr. Robson's role with the Company has

18
19
20 ⁶² Tr. at 58:17-25, 77:22 – 78:12; Soriano Dt. at 9:10-14.

21 ⁶³ Tr. at 96:5-9, 158:16-19.

22 ⁶⁴ Tr. 95:21 – 96:9.

23 ⁶⁵ Soriano Dt. at 3:17-18.

24 ⁶⁶ Company Final Schedules C-1 (water) and C-1 (wastewater).

25 ⁶⁷ Tr. at 59:13-18, 69:2 – 70:7. *See also* Ex. R-2.

26 ⁶⁸ *Id.* *See also* Soriano Rb. at 8:14-33; Bourassa Rb. at 12:1-12.

⁶⁹ *See* Tr. at 403:24 – 404:20; Soriano Dt. at 5:5-23.

⁷⁰ *See* Soriano Rb. at 9:4-10; Bourassa Rj. at 11:18 – 12:12; Tr. at 58:14-25, 77:17 – 78:8; Decision No. 58743 at 17:20 – 18:28; Decision No. 62184 at 11:10-18.

1 not changed so the Commission should continue to recognize the benefit in this rate
2 case.⁷¹

3 The Company's decision to propose an expense level for ratemaking below the
4 actual salary followed its discovery that it had mistakenly reported that Mr. Robson only
5 worked 112 hours for Pima during the test year.⁷² As Mr. Soriano explained, Mr. Robson
6 is a salaried employee and does not charge by the hour or keep time sheets.⁷³ The number
7 was inadvertently included in the response to a data request that contained information
8 from employees who do keep time sheets.⁷⁴ As soon as the Company realized that Staff
9 and RUCO were relying on the erroneous number of hours, the Company provided an
10 explanation. Specifically, Mr. Soriano testified that that the number should not have been
11 included in the schedule provided to the other parties in a data request response, and that
12 the number does not reflect the amount of time Mr. Robson spent in his job as Pima's
13 CEO and Chairman.⁷⁵ In the end, the Company does not know the exact number of hours
14 Mr. Robson worked for Pima during the test year. Nor is the Company basing its chief
15 executive's salary on hours.⁷⁶ It is basing it on the value he brings to the Company, a
16 value neither Staff nor RUCO dispute.

17 RUCO recommends a total salary expense of \$14,170, or just \$7,085 per division
18 per year.⁷⁷ RUCO's recommendation is based on an extrapolation of "some information
19 from prior testimony of salary related to another CEO of a Class A utility" from which
20 Mr. Mease "calculated it out based upon the hourly amount and multiplied by the number

21 _____
⁷¹ Soriano Dt. at 9:10-11.

22 ⁷² Tr. at 55:7 – 57:4; Soriano Rb. at 8:25 – 9:1.

23 ⁷³ Tr. at 59:7 – 60:3.

24 ⁷⁴ Tr. at 57:5-20, 61:3-12.

25 ⁷⁵ *Id.* See also Tr. at 63:22 – 64:15; Soriano Rb. at 8:25 – 9:1.

26 ⁷⁶ Tr. at 60:4-10, 159:8-15.

⁷⁷ Mease Dt. at 22:9-14, Schedule RBM-16; Mease Sb. at 18:6-11.

1 of hours reported as being worked by Mr. Robson.”⁷⁸ Both aspects of RUCO’s
2 recommendation are flawed.

3 First, the other utility is Arizona Water Company.⁷⁹ But RUCO does not explain
4 how it used that utility’s President’s salary to determine the hourly rate of \$125 RUCO
5 used to calculate its recommended expense level in this case.⁸⁰ All Mr. Mease, RUCO’s
6 designated witness on this issue, could say about the comparable salary from which he
7 extrapolated was that he did not know how many hours Arizona Water’s chief executive
8 worked, and that his salary, like Mr. Robson’s as proposed by the Company, is not likely
9 based on hours.⁸¹ He also had no idea what chief executives at any other Arizona utility
10 made.⁸² In short, Mr. Mease’s testimony lacked proper foundation.

11 Second, as explained above, the number of hours reported in response to the data
12 request was in error. It does not reflect how many hours Mr. Robson worked for Pima
13 during the test year. Nevertheless, Mr. Mease attempted to justify RUCO’s continued
14 reliance on the mistaken information by arguing that the other information in the data
15 request response was accurate, so he was assuming that Mr. Robson’s information was
16 accurate as well.⁸³ But Mr. Soriano explained why the information on the other
17 employees was different, an explanation Mr. Mease admitted he had no basis to dispute.⁸⁴
18 Mr. Mease further admitted that the other information that was provided reconciled to the
19

20 _____
⁷⁸ Tr. at 145:10-14.

21 ⁷⁹ *E.g.*, Tr. at 157:21-23.

22 ⁸⁰ *See* Coley Dt. at 30:1-7, Schedule TJC-15; Mease Dt. at 22:9-14, Schedule RBM-16; Mease Sb. at 18:6-
23 11.

24 ⁸¹ Tr. at 157:21 – 158:7. Notably, Mr. Mease was not involved in Arizona Water’s rate case and did not
25 work at RUCO at the time.

26 ⁸² Tr. at 157:18-20.

⁸³ Tr. at 147:7-15.

⁸⁴ Tr. at 154:19 – 155:2.

1 general ledger.⁸⁵ Put simply, the Company made an unfortunate mistake in its data
2 request response. But that does not justify RUCO's continued grip on the mistaken
3 number for its extremely low salary expense level.

4 In the final analysis, RUCO is using two numbers—one is a mistake and the other
5 is unexplained—to support an hours-based salary recommendation for Mr. Robson that
6 RUCO cannot compare to any other similarly situated utility. Ironically, RUCO's counsel
7 attempted to salvage RUCO's position at trial by eliciting testimony that Pima bears the
8 burden of proof on this issue.⁸⁶ That is not entirely accurate. The Company bears the
9 burden of proof on its recommendations.⁸⁷ The Company has proposed an expense level
10 and explained how it was determined and how it benefits from the expense. RUCO
11 admits it cannot produce evidence to dispute this testimony, thus the Company has met its
12 burden of proof on this issue. As for RUCO's recommended salary level, RUCO, not the
13 Company, bears the burden of proof, a burden RUCO simply has not met on this issue.⁸⁸
14 The evidence clearly demonstrates RUCO's reliance on erroneous and unsupported
15 information to produce an expense level that is far too low to be considered reasonable.

16 Staff recommends a salary level of just over \$27,000 at \$13,686 per division for
17 Mr. Robson.⁸⁹ According to Ms. Brown, "Staff sought to allocate his salary based on the
18 individuals that Mr. Robson oversees."⁹⁰ But Staff's reliance on NARUC, "cost causation
19 principles," and "cost drivers" doesn't justify Staff's recommended salary level.⁹¹ Pima
20

21 ⁸⁵ Tr. at 147:8-14.

22 ⁸⁶ Tr. at 162:3 – 163:9.

23 ⁸⁷ See generally, *State ex rel. Corbin v. Ariz. Corp. Comm'n*, 143 Ariz. 219, 223-24, 693 P.2d 362, 366-67
(App. 1984).

24 ⁸⁸ *Id.*

25 ⁸⁹ Staff Final Schedules CSB-8 (water) and CSB-12 (wastewater).

26 ⁹⁰ Tr. at 463:2-9.

⁹¹ Tr. at 463:10-20; Brown Dt. at 15:18 – 16:13.

1 employs Mr. Robson directly.⁹² The Commission has recognized this in previous rate
2 cases and approved a salary for Mr. Robson as part of the Company's operating
3 expenses.⁹³

4 Staff attempted to discount the Company's reliance on the salary expense level
5 approved in prior rate cases by claiming that the Company failed to present a required
6 "wage study."⁹⁴ As Ms. Brown explained it, the reason for the wage study was that
7 Mr. Robson does not work only for Pima.⁹⁵ Thus, it appeared Ms. Brown thought she
8 could justify Staff's decision to allocate Mr. Robson's salary, as it did, on the fact that the
9 Company had failed to comply with a related Commission directive in a prior rate case.
10 However, Ms. Brown was wrong and the study was submitted to the Commission.⁹⁶ As
11 Company Exhibit A-17 shows, the Company included a wage study in its prefiled
12 testimony in its rate case as directed by the Commission.

13 Furthermore, contrary to Ms. Brown's confusing explanations, NARUC does not
14 constrain the setting of a salary expense level for ratemaking purposes in this case.⁹⁷ And
15 the requirement that salaries and wages not be set at an "arbitrary" level is not a problem
16 in this case.⁹⁸ Again, the Company's recommended level of this expense is based on an
17 adjustment to the last approved salary level to account for customer growth and inflation.
18 That salary level was just and reasonable as a matter of law and no evidence has been
19 submitted to suggest that Mr. Robson's contribution to Pima has changed. Therefore,
20 again, the Company has met its burden of proof on this issue by proposing a reasonable

21 ⁹² Tr. at 463:21-22.

22 ⁹³ See Soriano Rb. at 9:4-10; Bourassa Rj. at 11:18 – 12:12; Tr. at 58:14-25, 77:17 – 78:8.

23 ⁹⁴ Tr. at 455:10 – 456:11.

24 ⁹⁵ *Id.* citing Decision No. 58743.

25 ⁹⁶ Ex. A-17.

26 ⁹⁷ Tr. at 465:20 – 466:1, 467:23 – 468:3.

⁹⁸ Tr. at 464:14-19.

1 salary expense level for its senior executive for ratemaking purposes and supporting it
2 with substantial evidence.

3 **B. Rate Case Expense**

4 1. Brief Statement of the Issues in Dispute

5 Staff and Pima agree that \$200,000 of rate case expense per division is
6 reasonable. They also agree that this amount should be subject to a 5-year
7 recovery period. However, they disagree on the mechanism to recover rate
8 case expense because Staff wants to continue to treat this expense like a
9 typical test year operating expense. RUCO recommends a lower amount of
10 rate case expense and a 4-year recovery period. But RUCO also
11 recommends a surcharge along with other alternatives and agrees that the
12 Company's rate case expense surcharge is a reasonable means of recovering
13 this expense. Ultimately, only the Company's recommended amount of rate
14 case expense and recovery mechanism are supported by substantial
15 evidence, reasonable, and fair.

12 2. Analysis and Argument

13 a. RUCO Has Not Met Its Burden of Proof on this Issue

14 Staff and Pima agree on the amount of rate case expense, \$200,000 per division,
15 and that this amount should be subject to a 5-year recovery period.⁹⁹ RUCO recommends
16 rate case expense of \$150,000 per division, \$50,000 less per division and \$100,000 less in
17 total than Staff and the Company.¹⁰⁰ RUCO bears the burden of producing credible,
18 substantial evidence to support its recommended level of rate case expense.¹⁰¹ RUCO has
19 fallen well short of meeting this burden.

20 RUCO's sole argument in support of this expense amount involves its comparison
21 of Pima's "proposed" amount of rate case expense to "other" rate cases before the
22 Commission.¹⁰² Not only did RUCO fail to give any consideration to the circumstances

23 _____
24 ⁹⁹ Tr. at 470:13-21; Bourassa Rj. at 14:14-19.

25 ¹⁰⁰ *E.g.*, Coley Dt. at 22:6-10; Mease Dt. at 14:18-22.

26 ¹⁰¹ *Corbin*, 143 Ariz. at 223-24, 693 P.2d at 366-67.

¹⁰² Coley Dt. at 22:12-16; Mease Dt. at 15:1-5.

1 actually present in this case, its comparison to the “other” rate cases was superficial and
2 ineffective. For example, RUCO looked at the last rate case for Sunrise Water Company.
3 RUCO characterized Sunrise as a “good yardstick” and the “most compelling
4 comparable,” apparently because Sunrise was also a Class B and an S corporation at the
5 time it filed a rate case in 2008.¹⁰³ Sunrise may be a Class B, but Sunrise only provides
6 water service, and has about 1/20 as many customers as Pima.¹⁰⁴ RUCO should have
7 considered these material differences, but when questioned, Mr. Coley didn’t even know
8 how many customers Sunrise had.¹⁰⁵

9 Nor did RUCO consider the significant difference between the Company and the
10 other two utilities it used as comparables – Arizona Water and UNS Gas. Specifically,
11 both of those utilities have in-house rate staff and in-house legal staff that provide support
12 for rate cases.¹⁰⁶ RUCO admitted that this factor would likely impact the amount of rate
13 case expense those utilities incurred, in addition to adding to a utility’s operating
14 expenses.¹⁰⁷ In contrast, the Company’s witness looked at several recent cases where the
15 utilities were actually comparable to Pima and then evaluated the differences, gave
16 thought to the specifics of this case, and reached an estimate.¹⁰⁸ RUCO didn’t look at any
17 of the comparable companies offered by Pima.¹⁰⁹ That the Company met its burden of
18 proof on this issue is further supported by Staff’s recommendation of the same expense
19 amount.

20 ¹⁰³ Coley Dt. at 22:20 – 23:12.

21 ¹⁰⁴ Bourassa Rb. at 16:9-12.

22 ¹⁰⁵ Tr. at 347:3-9.

23 ¹⁰⁶ Tr. at 347:13-25. Notably, RUCO considers Arizona Water as actually providing 3 comparables not 1
24 as it has filed rate cases for each of its 3 groups. Tr. at 346:4-22. But that does not change the fact that
Arizona Water has in-house rate staff.

25 ¹⁰⁷ Tr. at 347:10 – 348:8.

26 ¹⁰⁸ Bourassa Dt. at 12:8 – 13:22, 42:6-8, Bourassa Rb. at 16:14 – 17:10.

¹⁰⁹ Tr. at 348:15-17 (Mr. Coley actually had no idea which comparables the Company offered).

1 taking the authorized amount of rate case expense and determining how much needs to be
2 collected from each customer each month for 60 months.¹¹⁷ The recovery will stop when
3 the authorized amount is recovered. The Company will recover the amount of rate case
4 expense it is authorized to recover, no more and no less.¹¹⁸

5 RUCO does not oppose the rate case expense surcharge proposed by the
6 Company.¹¹⁹ RUCO agrees with the Company's methodology.¹²⁰ RUCO further agrees
7 that the Company's proposed surcharge will address its concerns regarding over-recovery
8 of rate case expense.¹²¹ Therefore, there is really no reason for the Company to continue
9 to incur rate case expense trying to decipher and argue against the various positions
10 RUCO has "offered," "recommended" and/or "advocated."¹²²

11 Staff opposes the proposed rate case expense surcharge because "the goal in
12 ratemaking is not to ensure or to guarantee recovery of every single line item in the
13 income statement."¹²³ But the Company is not asking the Commission to ensure and
14 guarantee the recovery of every item in the income statement. It is focused on one item—
15 rate case expense, an item that is **not** a typical operating expense. It is incurred mostly
16 outside the test year and won't be incurred during most of the period the approved rates
17 will be in effect.¹²⁴ Therefore, there are no changes in rate case expense that could occur
18

19 ¹¹⁷ Tr. at 97:17-21.

20 ¹¹⁸ Soriano Rb. at 4:3-5; Bourassa Rb. at 15:16-17; Tr. at 134:2-4.

21 ¹¹⁹ Tr. at 337:21-23, 338:18-21.

22 ¹²⁰ Tr. at 345:5-12. *See also* Coley Sb. at 9:10-14.

23 ¹²¹ Tr. at 349:24 – 350:2.

24 ¹²² Tr. at 136:16-20 (RUCO "offers" three different options – a surcharge, a longer normalization period or
25 simply reduce authorized amount of expense). But RUCO does not "advocate" any of these options – it
26 actually "recommends" that rate case expense be normalized over 4 years. Tr. at 337:9-25. But RUCO
does not oppose the Company's proposed rate case expense surcharge. *Id.*

¹²³ Tr. at 475:2-8. *See also* Tr. at 480:16-22.

¹²⁴ Bourassa Rb. at 13:10-18; Tr. at 350:19 – 351:9.

1 and result in a mismatch of rate base, expenses and customers.¹²⁵ Rate case expense is a
2 prepaid expense incurred in the present for the express and sole purpose of setting new
3 rates. GAAP recognizes this.¹²⁶ So does RUCO.¹²⁷ It is time the Commission did as
4 well. There is no question that approval of the surcharge is well within the Commission's
5 discretion.¹²⁸

6 **C. Income Tax Expense**

7 1. Brief Statement of the Issue in Dispute

8 The Company requests that the Commission include an income tax
9 allowance in the determination of the revenue requirement. The requested
10 amount of income tax expense is \$235,132 and \$255,017 for the water and
11 wastewater divisions, respectively. The Company asserts that income taxes
12 are a cost of service and should be recovered through rates. Allowing pass-
13 throughs to recover an income tax allowance will promote tax efficiency and
14 encourage needed investment. The opposition by Staff and RUCO confuses
15 tax liability and tax payment. FERC has recently changed its policy
16 regarding income taxes for pass-throughs and Pima respectfully suggests
17 that it is time for the Commission to do the same.

18 2. Analysis and Argument

19 The question of whether the Commission should include an income tax allowance
20 in the determination of Pima's revenue requirement has been the dominant issue of this
21 rate case. Several factors have contributed to this. The subject of a tax allowance for
22 pass-throughs has been an issue in several recent rate cases, as well as in workshops and
23

24 ¹²⁵ See Tr. at 480:23 – 481:3. See also Bourassa Rj. at 15:9-15.

25 ¹²⁶ Bourassa Rb. at 13:10-18.

26 ¹²⁷ Tr. at 351:4-9.

¹²⁸ Tr. at 482:1-5. This admission belies Staff's efforts to assert and/or imply that the surcharge is single-issue ratemaking, retroactive ratemaking, or contrary to NARUC. Staff admits the decision is within the discretion of the Commission. Other jurisdictions have also approved rate case surcharges. See, e.g., *Lakes Region Water Company, Inc.*, 2011 WL 2165037 (New Hampshire PUC 2011); *In re Centerpoint Energy Houston Elec., LLC*, 2005 WL 1668034 (Texas PUC 2005); *West Texas Utilities Co. v. Office of Public Utility Counsel*, 896 S.W.2d 261 (1995); *People ex rel. Madigan v. Illinois Commerce Com'n*, 2011 IL App (1st) 101776 (2011); *K N Energy, Inc. v. City of Scottsbluff*, 233 Neb. 644 (1989).

1 Staff meetings.¹²⁹ For Pima, the cost for being tax efficient, i.e., an S corporation, is
2 roughly \$500,000 based on Pima's proposed revenue requirement under the
3 Commission's current policy. The testimony of former ACC and FERC Commissioner
4 Marc Spitzer, who was at FERC when it defended and then implemented its new policy to
5 allow pass-through entities an income tax allowance, added to the attention on this issue.
6 The Company recognizes this is an issue of great interest in the regulated water/sewer
7 utility industry. It also respectfully suggests that the Commission can and should grant
8 the relief requested based on the evidence the Company has presented and on good and
9 balanced regulatory policy.

10 a. Pima Is an S Corporation Because It Is More Tax Efficient

11 Pima formed in 1972 but failed to make an election to be an S corporation.¹³⁰ The
12 next year, 1973, Pima made the election, became an S corporation, and remained an
13 S corporation until 1979.¹³¹ Prior to 1979, the Company and the Sun Lakes development
14 had the same ownership.¹³² Then, amidst an energy crisis and a recession, the owners of
15 the struggling development were asked to invest more capital in the utility.¹³³ There was a
16 "falling out," and three of the four partners agreed to remain and make the needed
17 investment only if the Company stopped making the S corporation election.¹³⁴
18 Apparently, the shareholders did not want to be responsible to pay taxes on the income of
19

20
21 ¹²⁹ See Tr. at 216 – 217, 222 – 228. "Pass-through" entities or "pass-throughs" as used herein refers to
22 S corporations, partnerships and LLCs, the latter being the preferred form of corporate structure for
23 entities that are not required to be C corporations. Spitzer Rb. at 6:1-3; Rigsby Dt. at 10, n.4.

24 ¹³⁰ Tr. at 387:23 – 388:3 (corporations are automatically C corporations unless an election is made to be an
25 S Corporation).

26 ¹³¹ Tr. at 388:14.

¹³² Tr. at 388:21 – 389:1.

¹³³ Tr. at 389:2-7.

¹³⁴ Tr. at 389:7-12.

1 an entity that was not paying a return.¹³⁵ Also, the corporate tax rates were at lower levels
2 than previously seen. In other words, in 1979, the shareholders sought what they viewed
3 as a more tax efficient strategy and the Company acquiesced in order to attract capital
4 needed for plant improvements.

5 Pima operated as a C corporation from 1979 until 1986 when Mr. Robson and the
6 new investors in Sun Lakes bought out the three leftover shareholders of Pima.¹³⁶ This
7 coincided with the Tax Reform Act of 1986 that, among other things, lowered the
8 individual tax rates below the corporate tax rates for the first time in roughly 40 years.¹³⁷
9 In 1986, Pima elected S corporation status and the Company has remained an
10 S corporation every year since then.¹³⁸ It has done so because it is the most tax efficient
11 strategy available for their company.¹³⁹

12 Pass-through entities have certain advantages over C corporations.¹⁴⁰ Specific
13 benefits include a lower ultimate tax rate, reduced administrative burden, and the
14 avoidance of double taxation on both income generated from operations and liquidation of
15 assets.¹⁴¹ Income taxes are an operating expense, like power, pensions and paperclips.¹⁴²
16 Regulators expect utilities to pay no more than they need to pay for these and all operating
17 expenses. Regulators should expect the same for taxes. Some regulators, like FERC, do
18 not want regulated entities to pay any more taxes than they need to.¹⁴³ Tax efficient

19 ¹³⁵ Tr. at 389:13-18.

20 ¹³⁶ Tr. at 390:1-3.

21 ¹³⁷ Tr. at 6:4-15.

22 ¹³⁸ Tr. at 390:7-14. *See also* Tr. at 277:7-10.

23 ¹³⁹ Tr. at 394:2-6.

24 ¹⁴⁰ Tr. at 181:9-14.

25 ¹⁴¹ Tr. at 179:20 – 180:3, 182:21-24, 230:6-10; Spitzer Rb. at 6:17-22.

26 ¹⁴² Tr. at 261:2 – 10. *See also* Staff's Exceptions to Hearing Officer's Proposed Opinion and Order (filed December 29, 1987, in Consolidated Water Utilities, Ltd., Docket Nos. E-1009-86-216, E-1009-86-217 & E-1009-86-332 (consolidated)) at 6:18-22.

¹⁴³ Tr. at 182:25 – 183:10.

1 entities are also better vehicles for getting incentives to invest; i.e., investors seem to
2 prefer investing in tax efficient entities.¹⁴⁴ Attracting capital is part of running a utility,
3 and the more efficiently the utility is run, the more ratepayers benefit.¹⁴⁵

4 This is why Mr. Spitzer testified that while at FERC, they thought making sure the
5 utility didn't pay more taxes than it had to was a benefit to both ratepayers and
6 shareholders.¹⁴⁶ In contrast, the Commission's current policy punishes pass-through
7 entities by disallowing tax recovery and forcing them to choose between an inefficient tax
8 structure or the disallowance.¹⁴⁷ That might be cheaper for ratepayers, at least in the
9 present, but that does not make it good policy.¹⁴⁸

10 b. The Company's Provision of Utility Service Gives Rise to
11 Actual (or Potential) Tax Liability

12 Pima does not remit a tax payment; instead it files an informational return with the
13 IRS and issues K-1s to its shareholders. The K-1s reflect the tax liability generated by the
14 Company's provision of utility services and each shareholder's allocation of that income
15 or loss for tax purposes.¹⁴⁹ Each shareholder must report that tax liability.¹⁵⁰ It is an
16 "actual or potential" liability.¹⁵¹ But ratepayers are **not** paying someone else's income
17 taxes—the so-called "phantom tax" argument is simply a stylish phrase that obfuscates the
18 truth: utility operations (usually) generate taxable income. Pima's customers would not

19 _____
20 ¹⁴⁴ Tr. at 245:1-5.

21 ¹⁴⁵ Tr. at 183:12-14.

22 ¹⁴⁶ Tr. at 183:16-21, 188:3-19.

23 ¹⁴⁷ Tr. at 185:13-23, 239:13 – 240:1.

24 ¹⁴⁸ Tr. at 185:21-23, 205:2-8, 220:18-22.

25 ¹⁴⁹ Tr. at 178:22 – 179:5, 231:14-16.

26 ¹⁵⁰ Tr. at 179:12.

¹⁵¹ Tr. at 249:20 – 250:23. The term "potential" was added to ensure that the owners are tax paying entities, not non-profits or public entities that do not have the potential to pay taxes. Tr. at 249:20 – 250:23.

1 be paying “someone else’s income taxes” any more than ratepayers are paying Pinnacle
2 West’s or Unisource’s shareholders taxes when APS and TEP customers pay rates that
3 include income tax expense. While the tax liability may be incurred at the Pima level,
4 Tier 1, it is the same tax at Tier 2, the shareholder level.¹⁵² To quote Commissioner
5 Spitzer quoting FERC:

6 The FERC Policy Statement not only rejects but demolishes the phantom
7 income argument. FERC’s Policy Statement approves the income tax
8 allowance for all pass-through entities without limitation. It is worth
9 quoting Paragraph 34 of the Policy Statement in its entirety:

10 As several commentators point out, a detailed discussion of the
11 realities of partnership tax practice was not before the court
12 when it reviewed the Opinion No. 435 orders. Because public
13 utility income of pass-through entities is attributed directly to
14 the owners of such entities and the owners have an actual or
15 potential income tax liability on that income, the Commission
16 concludes that its rationale here does not violate the court’s
17 concern that the Commission had created a tax allowance to
18 compensate for an income tax cost that is not actually paid by
19 the regulated utility. As explained in detail by the comments
20 summarized in sections A and D of Part II of this order, *the
21 reality is that just as a corporation has an actual or potential
22 income tax liability on income from the first tier public utility
23 assets it controls, so do the owners of a partnership or LLC on
24 the first tier assets and income that they control by means of
25 the pass-through entity.* (Emphasis added.)¹⁵³

18 It is just a simple “but for” test.¹⁵⁴ “Either the income arises from the operation of
19 the utility or it doesn’t.”¹⁵⁵ If it does, then income tax liability is a cost of service and “an
20 entity, pass-through entity, C entity, whatever” should be allowed to recover the cost of
21 that tax liability.¹⁵⁶ Staff recognized this before the *Consolidated Utilities* decision

22 ¹⁵² Tr. at 184:9-19.

23 ¹⁵³ Spitzer Rb. at 17:9-21 (quoting from *Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139
24 (2005)), Exhibit MLS-RB2.

25 ¹⁵⁴ Soriano Rb. at 7:6-12.

26 ¹⁵⁵ Tr. at 236:20-22.

¹⁵⁶ Tr. at 238:15-19.

1 reversed the Commission's policy on recovery of a tax allowance for pass-throughs.
2 Specifically, Staff argued in its exceptions to the recommended opinion and order that its
3 position was premised "upon the belief that the partner incurs tax liability as a result of
4 utility operations. Although the liability flows through to each partner, the expense
5 accrues as does depreciation, salary, maintenance or any other cost of service expense."¹⁵⁷
6 Staff was actually ahead of its time—this is FERC's "actual or potential" tax liability and
7 Pima's "but for" test. It isn't that taxes have ceased to be a cost of service to utilities,
8 whatever their structure (unless tax exempt); it's the Commission's policy on whether to
9 recognize that cost of service in rates that changed.

10 c. The Commission Can and Should Include an Income Tax
11 Allowance in Pima's Revenue Requirement

12 The opposition to Pima's request to recover an income tax allowance by RUCO
13 and Staff has been relentless and robust. However, while Staff and RUCO argue that the
14 Commission "should" not provide Pima an income tax allowance, they have not asserted
15 that the Commission "cannot" do so.¹⁵⁸ Both parties agree it is within the Commission's
16 discretion and that no law (or rule of NARUC or ACC) prevents the Commission from
17 allowing pass-throughs to recover an income tax allowance in their revenue
18 requirement.¹⁵⁹ They further acknowledge that the Commission has allowed
19 S corporations to recover income taxes as part of the cost of service in the past.¹⁶⁰ In
20

21
22 ¹⁵⁷ See Staff's Exceptions to Hearing Officer's Proposed Opinion and Order (filed December 29, 1987, in
23 Consolidated Water Utilities, Ltd., Docket Nos. E-1009-86-216, E-1009-86-217 & E-1009-86-332
(consolidated)) at 6:18-22.

24 ¹⁵⁸ Tr. at 270:25 – 271:2.

25 ¹⁵⁹ Tr. at 289:20-25, 312:2-9.

26 ¹⁶⁰ Tr. at 289:7-12, 312:10-23. Staff's witness testified that he did not review the Consolidated case and
was not aware that Staff had previously argued that income taxes were a cost of service for an
S corporation. Tr. at 312:17 – 313:8.

1 short, Staff and RUCO agree it is a policy decision of this Commission whether to do so
2 again.¹⁶¹

3 i. For RUCO, It Is All About Low Rates Now

4 RUCO uses the callow “phantom tax” argument as a pretext to suppress rates.¹⁶²
5 This extreme case of short term thinking is reminiscent of the “Barnburner” from the
6 1840’s, the mythical upstate New York Dutch farmer who burned down his barn to
7 eradicate the rats. Compelling a regulated utility to waste funds on a tax inefficient choice
8 of entity with the goal of transitory rate suppression is equally senseless. The
9 shareholders’ being harmed are the utility’s access to capital—like the farmer, who
10 burned his barn and got the rats, but destroyed something he needed in the process.

11 Even worse for RUCO’s argument, RUCO admits that APS received from the
12 Commission an income tax allowance during years when Suncor generated tax losses that
13 reduced or eliminated Pinnacle West’s federal and state income tax payments. RUCO
14 stubbornly refuses to acknowledge the distinction between the accrual of income and the
15 payment of tax because the APS example eviscerates its phantom tax argument. Instead,
16 RUCO retreats to an excerpt from David Cay Johnston’s article denying the legitimacy of
17 income recognized by pass-through entities.¹⁶³ Mr. Johnston’s argument, rejected by
18 FERC and the courts, is a pretext to artificially suppress rates.¹⁶⁴ RUCO would either
19 reward unnecessary tax payments by regulated utilities or punish tax efficiency. RUCO’s
20 position, in either event, creates an illusory ratepayer benefit no more enduring than the
21 Dutch farmer’s immolated barn.

22
23 ¹⁶¹ Tr. at 290:1-3, 311:22 – 312:10-23.

24 ¹⁶² Tr. at 271:2-18.

25 ¹⁶³ Rigsby Dt. at 13:7 – 14:8.

26 ¹⁶⁴ Spitzer Rb. at 7:14 – 8:1.

1 There is no such thing as phantom income tax.¹⁶⁵ As Mr. Spitzer explained in great
2 detail, this argument fails because it confuses tax liability with tax payment.¹⁶⁶ Income is
3 the incremental improvement in someone's lifestyle over the course of a year.¹⁶⁷ There
4 are always other factors that impact the amount of tax paid on income.¹⁶⁸ That the tax
5 might be paid in a different amount than is included in the revenue requirement for
6 ratemaking purposes does not change the fact that it is the utility that earned the income
7 providing utility service.¹⁶⁹ That's actually how it is with all expenses—a test year is used
8 with certain adjustments to estimate the amounts of expenses that will be incurred so a
9 revenue requirement can be built.¹⁷⁰ There is no post rate case true up of operating
10 expenses to ensure that the utility actually pays the amounts that were included in the
11 revenue requirement.¹⁷¹

12 RUCO's witness simply disagrees with this reasoning. For him, the fact that the
13 Company does not itself pay the income taxes is entirely dispositive.¹⁷² Curiously though,
14 Mr. Rigsby has no problem using a deduction for interest expense that a utility did not
15 actually deduct in determining a revenue requirement.¹⁷³ The fact that a utility does not
16 actually get an interest payment deduction does not prevent the Commission from using a
17 hypothetical capital structure to determine a revenue requirement.¹⁷⁴ Nor does the fact

18 ¹⁶⁵ Tr. at 190:17-23, 209:6.

19 ¹⁶⁶ Spitzer Rb. at 8:3 – 10:16. *See also* Tr. at 184:9-18, 235:13 – 236:1, 256:18 – 257:2.

20 ¹⁶⁷ Tr. at 233:1-2.

21 ¹⁶⁸ Tr. at 232:7-9. *See also* Tr. at 124:25 – 125:25 (bonus depreciation allowed by the IRS results in a
22 utility paying a very different amount of taxes than included in the revenue requirement).

23 ¹⁶⁹ Tr. at 235:19 – 236:1, 256:18-25; Spitzer Rb. at 9:7 – 10:16.

24 ¹⁷⁰ Tr. at 126:1 – 127:1. *See also* Tr. at 283:7 (expenses are set at a certain level and become part of the
25 revenue requirement).

26 ¹⁷¹ Tr. at 282:15 – 283:1.

¹⁷² Tr. at 271:2-4. *See also* Rigsby Dt. at 4:6-17; Rigsby Sb. at 3:21 – 4:3.

¹⁷³ Tr. at 285:17 – 287:15.

¹⁷⁴ Tr. at 287:17-21. *See also* 127:2-16; Bourassa Rb. at 23:20 – 24:3.

1 that APS does not pay income taxes preclude the Commission from including an income
2 tax allowance in its revenue requirement.¹⁷⁵ It is, as Mr. Rigsby said, “anybody’s guess”
3 how much tax APS’s parent actually pays.¹⁷⁶ But there is no post rate case true up for
4 C corporations that are part of a consolidated entity.¹⁷⁷ This would have been true even in
5 the years when APS’s affiliates, like Suncor, were losing money investing in real estate.¹⁷⁸

6 There is simply no material difference between determining a revenue requirement
7 for a C corporation that won’t actually pay the tax and the inclusion of an income tax
8 allowance for a pass-through. The stated reason for treating consolidated entities one way
9 and pass-throughs another—the former is a C corporation and is itself liable—fails.¹⁷⁹
10 The provision of service by a pass-through gives rise to a tax liability that is not paid by
11 the utility, just like the consolidated C corporation entity.¹⁸⁰ In truth, for RUCO the only
12 difference is that since *Consolidated Utilities*, the Commission has denied pass-throughs
13 income tax recovery and allowed it for C corporations that do not pay taxes, and RUCO
14 likes it that way.¹⁸¹

15 But this is not just about lower rates.¹⁸² It is about making sure that the citizens of
16 Arizona have the infrastructure they need, today and in the future. In some cases, that
17 infrastructure actually results in lower rates in the long run, as illustrated by the approval
18 of pipelines by FERC and the impact on the price of natural gas.¹⁸³ Had FERC not

19 ¹⁷⁵ Tr. at 284:2-5.

20 ¹⁷⁶ Tr. at 285:11-16.

21 ¹⁷⁷ Tr. at 284:10-14.

22 ¹⁷⁸ Tr. at 291:21 – 292:12. While Mr. Rigsby could not speak to the specifics of losses incurred by APS’
23 affiliates in the same consolidated structure, he readily agreed that such losses would have the effect of
offsetting the taxes owed by the parent for the liability arising from APS’ provision of utility services.

24 ¹⁷⁹ Tr. at 284:10-22.

25 ¹⁸⁰ See Tr. at 209:6-19, 238:15 – 239:1; Spitzer Rb. at 15:16-20; Bourassa Rb. at 24:11-17.

26 ¹⁸¹ Tr. at 277:23 – 278:2.

¹⁸² Tr. at 205:2-8.

¹⁸³ Tr. at 245:6 – 246:8.

1 changed its policy on income tax allowances for pass-throughs, those additional pipelines
2 likely would not have been built, and customers would have less access to energy
3 resources and would have to pay more for those resources they can obtain.¹⁸⁴ Again, tax
4 efficient entities are more attractive to investors and investors fund the infrastructure that
5 benefits customers.¹⁸⁵ This is why, as Mr. Spitzer explained, a policy that incents
6 investment benefits ratepayers,¹⁸⁶ and so does a policy that incents utilities to be more
7 efficient, including tax efficiency.¹⁸⁷

8 RUCO's position clearly portrays the Hobson's choice described by Mr. Spitzer.¹⁸⁸
9 As Mr. Soriano explained in response to a question by counsel for RUCO:

10 "the current policy of not allowing recovery for income taxes puts us in an
11 awkward position, because it disincentivizes us to take the most efficient tax
12 structure, which is an S corp. It creates a conflict. On the one side we want
13 to be an S corp. because that's the most efficient tax structure, but it is
inefficient because under present policy . . . it doesn't allow for recovery of
income taxes."¹⁸⁹

14 Mr. Soriano further explained that if the Commission denies the requested relief, the
15 Company will have to go back and evaluate staying an S corporation.¹⁹⁰ That this could
16 cost ratepayers more in the long run, both in higher taxes and reduced investment capital,
17 doesn't bother RUCO. RUCO unabashedly and repeatedly suggests that the Company
18 select the more inefficient tax structure.¹⁹¹ In other words, RUCO recommends that if
19 pass-through entities want to be made whole for their costs of service, they should pursue

20 ¹⁸⁴ *Id.*

21 ¹⁸⁵ *Id.*

22 ¹⁸⁶ Tr. at 262:5-12.

23 ¹⁸⁷ Tr. at 264:13-18.

24 ¹⁸⁸ *See also* Tr. at 392:15-23.

25 ¹⁸⁹ Tr. at 392:15-23.

26 ¹⁹⁰ Tr. at 394:17-22, 395:5-7.

¹⁹¹ *See* Rigsby Dt. at 5:22 – 6:2; Rigsby Sb. at 6:5-8; Tr. at 273:11 – 274:9.

1 the least efficient tax structure available and pay more taxes than they need to pay. Like
2 Mr. Rigsby said, if Pima doesn't convert, ratepayers "benefit" through suppressed rates
3 under the Commission's current policy, which again, is RUCO's ultimate goal, even if it's
4 at odds with the ratepayers' long-term interests.¹⁹²

5 ii. Staff's Opposition Is Misdirected and Unpersuasive

6 Staff's recommendation that the Commission deny an income tax allowance is
7 actually more multi-faceted than RUCO's. Staff apparently doesn't think the Commission
8 should decide this issue in this rate case because there is an upcoming workshop and
9 because Staff was writing a report.¹⁹³ But if the Commission does decide the issue, Staff
10 thinks the income tax allowance should be denied.

11 Staff should not be allowed to gain an advantage in this matter due to its unique
12 role. Until this case came up, there was no deadline in place for its report to be issued and
13 no schedule in place regarding that proceeding.¹⁹⁴ Now, to make matters worse, as a
14 result of this case, Staff has submitted a Staff Report on the issue of income tax allowance
15 for pass-throughs on June 27, 2012, four business days before closing briefs are due.
16 Whether by design, panic, or happenstance, Staff has positioned itself to seek to evade the
17 issue while simultaneously attacking the relief requested from multiple fronts.

18 To be clear, Pima has never suggested that the Commission should not conduct
19 workshops or adopt policies concerning the recovery of income taxes by pass-throughs.
20 With or without a policy statement though, Pima still needs a rate case for a tax allowance
21 to be included in its revenue requirement.¹⁹⁵ One should not be put in front of the other;

22
23
24 ¹⁹² Tr. at 277:19 – 278:2.

25 ¹⁹³ Tr. at 118:16-21, 131:25 – 132:14, 218:16-19, 322:19 – 323:13.

26 ¹⁹⁴ Tr. at 329:14 – 330:6.

¹⁹⁵ Tr. at 218:9-11. *See also* Tr. at 266:15-21.

1 both should be done.¹⁹⁶ This is Pima’s rate case. The issue will be fully briefed and it can
2 and should be decided. To the extent it contributes to and furthers the Commission’s goal
3 to forge a policy on this issue, then this case is simply an opportunity to synchronize
4 ratemaking with good business practice. There is no reason not to decide the issue in
5 favor of some other as yet unknown and undefined proceeding.

6 On the merits of what the Commission should decide, Staff puts its own spin on the
7 “phantom tax” argument by casting the Company’s request as a request to “pay personal
8 income taxes.”¹⁹⁷ This issue is briefed in detail above. For its part, Staff chose not to
9 comment on the FERC policy, except to say that the Commission is not obligated to
10 follow FERC, and that Arizona does not have to consider the “national interstate
11 influences” that FERC does.¹⁹⁸ The Company agrees that this Commission is not bound
12 by FERC. The Company called Mr. Spitzer because it believes he, as a former Arizona
13 Commissioner and tax attorney, was in a unique position to share FERC’s reasons for
14 changing its policy and allowing pass-through entities an income tax allowance. It is that
15 reasoning that the Company suggests is persuasive. Not just at a national level, but at
16 every level where regulators wish to promote efficiency, incent investment, and balance
17 the interests of customers and shareholders.

18 Staff also claims that “it has shown” that “shareholders are not harmed in any way”
19 by the current policy that denies a tax allowance to pass-through entities.¹⁹⁹ However, the
20 Commission should not put much stock in the conclusions drawn from Staff’s Tables.²⁰⁰
21 For one thing, Mr. Carlson may have adopted Ms. Brown’s testimony, but he did not do

22
23 ¹⁹⁶ Tr. at 254:15-19.

24 ¹⁹⁷ Brown Sb. at 12:22-24; Tr. at 303:13-17.

25 ¹⁹⁸ Tr. at 302:23 – 303:5.

26 ¹⁹⁹ Tr. at 303:7-10, 314:11-14.

²⁰⁰ See Brown Sb. at Tables A and B.

1 the research or prepare the tables and could not “attest” to all of the information.²⁰¹ Nor
2 could he dispute or even address any of Mr. Bourassa’s testimony showing that these
3 tables contained errors and worse, presented an apples-to-oranges rather than an apples-to-
4 apples comparison.²⁰² But he did agree with Mr. Bourassa that the comparison was not an
5 apple to an apple.²⁰³ Mr. Carlson further agreed that the results of Staff’s analysis were
6 dependent on the selection of inputs.²⁰⁴ In sum, to paraphrase the 19th Century Scottish
7 poet, novelist and fairy tale writer Andrew Lang, Staff uses those Tables “as a drunken
8 man uses lampposts, for support, rather than for illumination.”

9 d. The Tax Allowance Should Be Calculated in the Manner
10 Recommended by the Company

11 Determining that the Company’s revenue requirement will include an allowance
12 for income taxes does not end the inquiry. The Commission must also determine how
13 much the income tax allowance should be.²⁰⁵ The Company’s proposed income tax
14 allowance calculation started with consideration of the FERC methodology.²⁰⁶ The basic
15 FERC methodology is summarized as follows:

- 16 1. Drill down through all stockholders until a taxable or
17 nontaxable entity is reached.
- 18 2. Establish a marginal tax rate for each taxable entity (FERC
19 typically uses presumptive rates of 28% for all individual
20 taxpayers and 35% for taxable entities).
- 21 3. Calculate a weighted average tax rate for the combined
22 ownership.

23 ²⁰¹ Tr. at 314:25 – 315:3, 319:15-17. *See also* Bourassa Rj. at 17 – 19.

24 ²⁰² Tr. at 314:25 – 315:3.

25 ²⁰³ Tr. at 316:24 – 317:10, 318:24 – 319:12.

26 ²⁰⁴ Tr. at 319:25 – 320:3.

²⁰⁵ *See* Tr. at 266:1-21.

²⁰⁶ Tr. at 119:19 – 120:5.

1 4. Use weighted average tax rate for calculating income tax
2 allowance.²⁰⁷

3 But Mr. Bourassa went further. Rather than use the FERC presumptive marginal tax rates
4 of 28 percent for individuals and 35 percent for taxable entities, he computed the actual
5 effective tax rates for individuals and entities based upon their proportionate share of
6 income at proposed revenues using the applicable federal and state tax rates.²⁰⁸ By
7 including computed individual effective tax rates (federal and state), Mr. Bourassa
8 reached a 27.5 percent effective tax rate.²⁰⁹ Thus, in the end, Mr. Bourassa “drilled down”
9 further and came up with a lower effective federal tax rate compared to the FERC
10 approach.²¹⁰

11 Because Staff does not agree there should be a tax allowance, Staff did not review
12 the Company’s proposal for the calculation of the allowance.²¹¹ Neither did RUCO it
13 would appear. Thus, the Commission has only the Company’s proposal before it in this
14 case. Staff’s suggestion that the Commission determine an actual effective tax rate is not
15 explained and is of little help.²¹² Looking at the individual shareholders’ returns is
16 “ludicrous.”²¹³ Among other problems, the amount of taxes actually paid by tax paying
17 entities varies from year to year.²¹⁴ Staff agrees.²¹⁵ This is why the Commission does not
18 base income tax allowances for C corporations on actual tax payments either.²¹⁶ As

19 ²⁰⁷ Bourassa Dt. at 17:1-11.

20 ²⁰⁸ Bourassa Rb. at 17:12 – 18:5.

21 ²⁰⁹ *Id.*

22 ²¹⁰ *Id.*

23 ²¹¹ Tr. at 322:8-14.

24 ²¹² Tr. at 322:15-18, 323:20-22.

25 ²¹³ Tr. at 208:3-23.

26 ²¹⁴ Tr. at 292:2-3.

²¹⁵ Tr. at 317:18-23, 324:20-25, 331:2-20.

²¹⁶ Tr. at 209:6-19, 234:15-22. *See also* Spitzer Rb. at 11:12-14, 13:16 – 14:2.

1 Mr. Spitzer testified in response to a question from Staff, “I don’t know of any case where
2 a utility, a regulated utility that’s a C corporation, publicly traded, earned income from
3 utility operations [and then] had a commission disallow its cost of service, that income tax
4 allowance, because of [an affiliate] loss.”²¹⁷

5 There is no reason pass-throughs should be treated in a different manner. Taxes
6 are a cost of service.²¹⁸ The Commission can set a reasonable expense level for this cost
7 of service as it does every other cost of service. The Company has presented a reasonable
8 and conservative calculation for an income tax allowance. Pima respectfully asks that the
9 Commission use that tax rate (approximately 27.5 percent)²¹⁹ to calculate an allowance for
10 income taxes to be included in the Company’s revenue requirement.

11 12 **IV. Cost of Capital and Rate of Return**

13 **A. Capital Structure and Cost of Debt**

14 Staff, RUCO, and the Company recommend a capital structure of 64.6 percent
15 equity and 35.4 percent debt.²²⁰ This capital structure is based on a pro forma adjustment
16 proposed by Pima and adopted by Staff and RUCO.²²¹ Pima proposed a more leveraged
17 capital structure than its test year capital structure to reflect the recent approval of new
18 debt financing by this Commission.²²² That loan, which is expected to close before the
19
20

21 ²¹⁷ Tr. at 236:6-12. *See also* Tr. at 236:16-20.

22 ²¹⁸ Tr. at 209:16-19. *See also* Spitzer Rb. at 2:24-26, 7:9-12.

23 ²¹⁹ Company Final Schedules at C-1, page 1 (water) and C-1, page 1 (wastewater).

24 ²²⁰ Company Final Schedules D-1 (water) and D-1 (wastewater); Cassidy Sb. at Schedule JAC-1; RUCO
Final Schedules RBM-19 (water) and TJC-18 (wastewater).

25 ²²¹ Bourassa COC Rb. at 5:12-23.

26 ²²² *See* Decision No. 73078 (April 5, 2012).

1 decision in this case, is estimated to be at 4.25 percent.²²³ The parties have used this as
2 the cost of debt in determining their rates of return.²²⁴

3 Pima will use the debt proceeds to build needed plant, refinance an existing
4 higher-cost loan, and further rebalance its capital structure to make it more leveraged.
5 Pima took these steps coincident to this rate case because they benefit the customers
6 through lower rates. Debt is less expensive than equity,²²⁵ especially today when rates
7 remain at historical lows.²²⁶ By putting in more debt at lower rates, the Company has
8 reduced its cost of service. Of course, the Company's shareholders have taken on more
9 financial risk as a result of the new debt, risk that needs to be reflected in the return on
10 equity. RUCO and Staff have failed to adequately account for the additional risk in their
11 ROEs.

12 **B. Return on Equity**

13 1. Brief Statement of the Issue in Dispute

14 The 9.4 percent ROEs recommended by Staff and RUCO are simply too low
15 to be approved as just and reasonable returns on rate base under the facts
16 presented in this rate case. In contrast, the 10.5 percent ROE recommended
17 by the Company is conservative, withstood several "reality" checks, is fair,
18 and should be approved.

19 2. Analysis and Argument

20 a. Overview

21 The return on common equity (ROE) requested by the Company is 10.5 percent,
22 based on the updated analysis presented in Mr. Bourassa's rebuttal testimony.²²⁷ This

23 ²²³ Tr. at 50:18 – 51.2.

24 ²²⁴ Company Final Schedules D-1 (water) and D-1 (wastewater); Cassidy Sb. at Schedule JAC-1; RUCO
25 Final Schedules RBM-19 (water) and TJC-18 (wastewater).

26 ²²⁵ Tr. at 360:4-17.

²²⁶ Tr. at 50:22, 359:24 – 360:3

²²⁷ Company Final Schedules D-1 (water) and D-1 (wastewater); Bourassa COC Rb. at 5:12-19.

1 results in a rate of return on its rate base based on a WACC of 8.29 percent.²²⁸ In his
2 analysis, Mr. Bourassa utilized the same market-based finance models—the DCF and the
3 CAPM—that the Commission has relied on in numerous water and wastewater utility rate
4 cases during the past decade.²²⁹ These models are implemented through the use of
5 financial information for comparable firms with common stock that is traded on a national
6 exchange. Because Pima’s stock is not publicly traded, Mr. Bourassa used as his proxy
7 the same six publicly traded water utilities that Staff has consistently used in prior water
8 and wastewater utility rate cases.²³⁰

9 Following his DCF and CAPM modeling, Mr. Bourassa then tested his results.
10 First, he used the Build-Up Method using the Duff & Phelps data.²³¹ Because this
11 methodology does not need market data to use, it is ideal for non-publicly traded
12 companies.²³² There are no assumptions about betas or dividend yields that require a
13 market price for the stock. The method also takes into account size, which the empirical
14 financial data and many studies show has an impact on equity costs.²³³ This comports
15 with common financial sense—investors will see Hilton hotels as better investments than
16 a mom and pop hotel located near the airport. The risks are simply not the same. In any
17 case, the Build-Up Method produces much higher results, showing again that
18 Mr. Bourassa’s recommendation was conservative.

19
20
21 ²²⁸ *Id.*

22 ²²⁹ See, e.g., *Rio Rico Utilities, Inc.*, Decision No. 67279 (Oct. 5, 2004) at 13 (“The DCF and CAPM are
23 respected, sound and oft relied upon models for determining a firm’s cost of equity.”); Hearing Exhibit A-
24 25, which was admitted in Rio Rico Utilities’ 2009 rate case, Docket No. WS-02676A-09-0257 (excerpt
25 from Staff’s cost of capital testimony in the Rio Rico’s prior rate case).

24 ²³⁰ Bourassa COC Dt. at 16-25 (describing sample utilities).

25 ²³¹ Bourassa COC Dt. at 39:9 – 41:14.

26 ²³² Bourassa COC Dt. at 39:16-18.

²³³ Bourassa COC Dt. at 40:8-22.

1 But Mr. Bourassa was not finished. He then made two appropriate adjustments to
 2 account for Pima's specific risk profile. First, Mr. Bourassa determined that the cost of
 3 equity produced by the DCF and CAPM should be adjusted downward by no more than
 4 40 basis points to account for the amount of debt in the Company's capital structure
 5 relative to the sample utilities using the method normally used by the Commission.²³⁴
 6 Second, he determined that the cost of equity should be adjusted upward by no less than
 7 80 basis points to account for the Company's small size relative to the proxy companies;
 8 Pima's lack of investment liquidity (i.e., an equity investment in the Company cannot be
 9 sold quickly on a stock exchange); and the additional risk that results from the particular
 10 ratemaking methods employed in Arizona.²³⁵ The table below summarizes the
 11 Company's final position:

<u>Method</u>	<u>Low</u>	<u>High</u>	<u>Midpoint</u>
Range DCF Constant Growth Estimates	9.7%	11.3%	10.5%
Range of CAPM Estimates	<u>8.2%</u>	<u>13.7%</u>	<u>10.9%</u>
Average of DCF and CAPM midpoint estimates	<u>8.9%</u>	<u>12.5%</u>	<u>10.7%</u>
Financial Risk Adjustment	-0.3%	-0.3%	-0.3%
Specific Company Risk Premium	<u>0.5%</u>	<u>1.0%</u>	<u>0.8%</u>
Indicated Cost of Equity	9.1%	13.2%	11.2%

21 Staff and RUCO's cost of capital witnesses also used the DCF and CAPM to
 22 develop their cost of equity recommendations. There are, however, significant differences
 23 between the inputs used by Mr. Bourassa and the inputs used by the witnesses for Staff

24 ²³⁴ Bourassa COC Dt. at 41 – 42. This method is often called the Hamada formula because it was
 25 developed by Professor Robert Hamada of the University of Chicago. As discussed below, it is an
 extension of CAPM and also relies on market-based inputs. *Id.*

26 ²³⁵ Bourassa COC Dt. at 42 – 44.

1 and RUCO. As a result, the estimates produced by their models differ from
2 Mr. Bourassa's estimates:

3 <u>Party</u>	<u>DCF</u>	<u>CAPM</u>	<u>Average</u>
4 Pima	10.5%	10.9%	10.7%
5 Staff	9.0%	9.7%	9.4%
6 RUCO	8.94%	4.58%	9.4% ²³⁶

7
8 b. Applicable Legal Standards

9 It is often said that determining an ROE is part art, part science. Still, there are
10 legal standards intended to ensure utilities such as Pima have an opportunity to earn the
11 reasonable cost of conducting their business, including a return on its property devoted to
12 public service. That return must be sufficient to: (1) allow the utility to attract capital on
13 reasonable terms; (2) maintain the utility's financial integrity; and (3) allow the utility an
14 opportunity to earn a return that is commensurate with the returns earned by enterprises
15 with comparable risks.²³⁷ The seminal case stating these requirements is *Bluefield Water*
16 *Works*, in which the Supreme Court explained:

17 A public utility is entitled to such rates as will permit it to earn a return on
18 the value of the property which it employs for the convenience of the public
19 equal to that generally being made at the same time and in the same general
20 part of the country on investments in other business undertakings which are
21 attended by corresponding risks and uncertainties; but it has no
22 constitutional right to profits such as are realized or anticipated in highly
23 profitable enterprises or speculative ventures. The returns should be
24 reasonably sufficient to ensure confidence in the financial soundness of the
25 utility and should be adequate under efficient and economical management,

24
25 ²³⁶ Bourassa COC Rb. at Schedule D-4.1; Cassidy Sb. at Schedule JAC-3; Rigsby Dt. at Schedule WAR-1,
page 3 of 3.

26 ²³⁷ See Bourassa COC Dt. at 14.

1 to maintain and support its credit and enable it to raise the money necessary
2 for the proper discharge of its public duties.²³⁸

3 The Supreme Court also stated: "Rates which are not sufficient to yield a reasonable
4 return on the value of the property used at the time it is being used to render the service
5 are unjust, unreasonable and confiscatory, and their enforcement deprives the public
6 utility company of its property in violation of the Fourteenth Amendment."²³⁹ Thus, the
7 rates set in this proceeding must be sufficient to allow the Company to earn its authorized
8 rate of return during the period the rates will be in effect.

9 In a more recent case, the Supreme Court repeated these requirements, explaining:

10 [T]he investor interest has a legitimate concern with the financial integrity
11 of the company whose rates are regulated. From the investor or company
12 point of view it is important that there be enough revenue not only for
13 operating expenses but also for capital costs of the business. These include
14 service on the debt and dividends on the stock.... By that standard the return
15 to the equity owner should be commensurate with returns on investments in
16 other enterprises with corresponding risks. The return, moreover, should be
17 sufficient to assure confidence in the financial integrity of the enterprise, so
18 as to maintain its credit and to attract capital.²⁴⁰

16 The criteria established by the Supreme Court in decisions such as *Bluefield Water*
17 *Works* and *Hope Natural Gas* require the use of comparable companies, i.e., companies
18 that would be viewed by investors as having similar risk. However, there is no
19 comparable market data for small utility companies like Pima. The average revenue of
20 the proxy water utilities is over 66 times that of Pima, and the average net plant of the
21 water utility sample companies is over 54 times that of the Company.²⁴¹ Even the
22 smallest company in the proxy group, Connecticut Water, has over 16 times the net plant

23 _____
24 ²³⁸ *Bluefield Water Works v. Public Service Comm'n*, 262 U.S. 679, 692-693 (1923).

25 ²³⁹ *Id.* at 690.

26 ²⁴⁰ *Federal Power Comm'n v. Hope Natural Gas*, 320 U.S. 591, 603 (1944).

²⁴¹ Bourassa COC Dt. at 16.

1 of Pima and nearly 14 times the revenue.²⁴² The simple truth is that no rational investor
2 would regard Pima as having the same level of risk as Aqua America or even Connecticut
3 Water, nor can Pima effectively compete with those firms to attract capital on reasonable
4 terms. Consequently, the results produced by the DCF and CAPM methodologies,
5 utilizing data for the proxy utilities, understates the cost of equity for Pima.

6 In addition, the Commission should consider the specific risks affecting the
7 utility's operations and earnings, including risks created by the regulatory standards and
8 requirements to which the utility is subject. The Supreme Court has stated:

9 [T]he impact of certain rates can only be evaluated in the context of the
10 system under which they are imposed. One of the elements always relevant
11 to setting the rate ... is the return investors expect given the risk of the
12 enterprise. ... The risks a utility faces are in large part defined by the rate
13 methodology because utilities are virtually always public monopolies
14 dealing in an essential service, and so relatively immune to the usual market
15 risks.²⁴³

16 In short, "[r]egulation can increase business risk if it does not provide adequate returns
17 and/or if it does not provide the utility with the opportunity to earn a fair rate of return."²⁴⁴

18 Consequently, the impact of the Commission's particular rate-setting policies and
19 requirements on a utility's ability to actually earn its authorized rate of return at the time
20 service is provided must be taken into account in determining a fair rate of return. For this
21 reason, in this case, the Company has proposed an upward adjustment to the cost of equity
22 of no less than 80 basis points to account for its small size, lack of investment liquidity
23 and the additional risk created by Arizona's particular ratemaking system.

24 ²⁴² *Id.*

25 ²⁴³ *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 314 – 15 (1989).

26 ²⁴⁴ Roger A. Morin, *New Regulatory Finance* 38 – 39 (Public Utility Reports, Inc. 2006).

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

c. Only The Company's ROE Is Reasonable

That determining an ROE is part art, part science, and thus involves an unavoidable amount of subjectivity, does not negate the need to conduct some sort of sanity check on the results of all these financial models. An expert should carefully consider the inputs used and the results obtained. RUCO clearly has not done that in this case. For one thing, RUCO's CAPM (shown above) is only 4.58 percent. This is 500 points lower than Staff's and 600 points lower than the Company's. No investor is going to invest in an Arizona water utility for a shot at a 4.58 percent return. The number is absurdly low. RUCO's DCF is also relatively low at 8.9 percent, lower than its actual ROE. That RUCO rejected its own results in favor of a higher ROE than derived from its financial models illustrates the limits in the models and the use of the results of the models.

Similarly, RUCO's failure to adjust its ROE upward after it increased the amount of debt in the capital structure casts further suspicion on RUCO's recommendations. For years RUCO has preached that utilities need to use more debt because debt costs are low and debt is less expensive.²⁴⁵ When a utility has too little debt, RUCO recommends use of hypothetical capital structures to reflect debt that would have been used to lower the cost of service. Yet, when Pima took on more debt, increasing its financial risk, RUCO's ROE did not change.²⁴⁶ This sends the message that taking on more financial risk may not be worth the risk, which will leave many Arizona ratepayers unable to benefit from historically low debt costs. This is not good policy and in sum, RUCO's analysis was very subjective—so much so that its attempt to keep down the Company's return has rendered its recommendation unusable and unreasonable.

²⁴⁵ Tr. at 359:18-22.

²⁴⁶ Tr. at 360:20 – 361:6.

1 Staff's ROE is also 9.4 percent, but Staff did not have to artificially inflate the
2 results of its models to get to its recommended ROE. Nor does it appear that Staff has to
3 defend its models from evidence rebutting the validity of its results. Instead, Staff's
4 witnesses spent most of his time explaining an alleged mistake that he felt undermined
5 Mr. Bourassa's results. As Mr. Bourassa explained in detail, however, no mistake was
6 made and Mr. Bourassa was following the same methods Staff has used in the past and
7 Staff's witness was just confused.²⁴⁷ Additionally, Staff, like RUCO, failed to adequately
8 adjust for the increase in the Company's financial risks due to the addition of the new
9 debt. In the final analysis, while the Company's recommended return is only 110 basis
10 points higher than those offered by Staff and RUCO, it is the difference between a return
11 that is just and reasonable and one that is not.

12 **V. Rate Design and Other Tariff Changes**

13 Mr. Bourassa said it best—in this rate case, rate design has been a “process of
14 modifying and refining.”²⁴⁸ As a result, several rate design issues were resolved through
15 the efforts of the parties' experts. For example, in his rebuttal, Mr. Bourassa testified to
16 his concerns with Staff's rate design for the water division.²⁴⁹ In response, Staff made
17 considerable changes to its rate design in surrebuttal.²⁵⁰ Similarly, Mr. Bourassa
18 questioned the merits of RUCO's scaling of the monthly minimums for the wastewater
19 division.²⁵¹ RUCO agreed and discarded the multiplier in its surrebuttal.²⁵² Mr. Bourassa
20 also discovered errors in both Staff's and RUCO's revenue proofs that were corrected.²⁵³

21 ²⁴⁷ Tr. at 490:19 – 495:22.

22 ²⁴⁸ Bourassa Rj. at 21:17-21.

23 ²⁴⁹ Bourassa Rb. at 28:3 – 34:13.

24 ²⁵⁰ Brown Sb. at 21:1-6.

25 ²⁵¹ Bourassa Rb. at 40:14 – 41:4.

26 ²⁵² Coley Sb. at 16:20 – 17:3.

²⁵³ Bourassa Rb. at 34:14-19, 40:9-14, 41:5-13; Bourassa Rj. at 22:12 – 23:23, 26:12-21; Brown Sb. at 21:4-6; Coley Sb. at 18:10-16.

1 There are now only two rate design issues Pima wishes to address further. Each is
2 addressed below.

3 **A. Staff's Rate Design Still Sends a Mixed Conservation Message**

4 1. Brief Statement of the Issue in Dispute

5 Staff's rate design is a vast improvement over past rate designs offered by
6 Staff for water companies, however it still has some flaws. The primary
7 flaw in Staff's rate design is its reduction to the first tier commodity rate,
which sends the wrong price signal to consumers.

8 2. Analysis and Argument

9 As noted above, Staff's rate design changed significantly from direct to
10 surrebuttal.²⁵⁴ Staff accomplished this by placing a greater emphasis on the monthly
11 minimum.²⁵⁵ This is a step in the right direction as it reduces the Company's exposure to
12 revenue erosion.²⁵⁶ In fact, Staff's monthly minimum recovers a greater percentage of the
13 revenue than does the Company's.²⁵⁷ A higher monthly minimum creates more stable
14 revenue for the utility, which is the problem with RUCO's rate design in this proceeding.
15 Even though Staff's is better, the Company was unable to adopt all of the beneficial
16 elements of Staff's rate design. The primary reason for this is that Staff's rate design also
17 includes a reduction in the commodity rate in the first tier.

18 The Company does not believe it is appropriate to reduce the price of water.²⁵⁸ It
19 has been 20 years since Pima's customers have experienced a change in their water rates.
20 Sending a price signal that water is less expensive today is contrary to the goal of water
21 conservation. Pima believes that customers should be urged to conserve water at all usage

22
23 ²⁵⁴ Brown Sb. at 21:1-6.

24 ²⁵⁵ Bourassa Rj. at 21:22-23.

25 ²⁵⁶ See Bourassa Rj. at 21:23-25.

26 ²⁵⁷ Tr. at 99:9 – 100:15.

²⁵⁸ Tr. at 100:7-9.

1 levels. The Commission should do this by adopting a rate design that “provides the
2 Company with its required revenues, avoids subsidies as much as possible, and provides
3 proper price signals to customers.²⁵⁹ Staff’s rate design gets close but suffers from the
4 reduction to the first tier commodity rate. The Company’s rate design achieves all of
5 these goals.

6 **B. RUCO’s Higher Effluent Commodity Rate is Unsupported**

7 1. Brief Statement of the Issue in Dispute

8 The commodity rates for effluent and irrigation should be set at the same
9 levels. RUCO’s reasons for a much higher effluent rate are unsupported and
10 do not constitute substantial evidence.

11 2. Analysis and Argument

12 Staff and the Company propose the same commodity rates for effluent and
13 irrigation water.²⁶⁰ RUCO proposes a higher commodity rate for effluent than it does for
14 irrigation.²⁶¹ The sole reason RUCO offered for this difference is that it met with one of
15 the HOAs in Sun Lakes and that HOA claimed that the irrigation water was of a lower
16 quality.²⁶² This is not substantial evidence. The Commission should not base the rates for
17 irrigation and effluent on unsubstantiated hearsay about technical issues—water quality
18 and cost of service. This is especially true in this case where there are good reasons to
19 price effluent and irrigation at the same levels.²⁶³ RUCO did not rebut this evidence or
20

21 ²⁵⁹ Bourassa Rj. at 23:9-12.

22 ²⁶⁰ Actually, Staff’s rate differs by \$.01 in Staff’s Final Schedules. See Staff Final Schedules at CSB-19,
23 page 3 of 4 (water) and CSB-20 (wastewater). This slight change is not explained. The Company
proposes that the rates be the same. See Pima Final Schedules at H-3, page 2 (water) and H-3, page 1
(wastewater).

24 ²⁶¹ Tr. at 351:19-25. See also RUCO Final Schedules at RBM RD-2 (water) and TJC RD-3 (wastewater).

25 ²⁶² Coley Sb. at 17:18 – 18:6. See also Tr. at 352:1-15.

26 ²⁶³ Bourassa Rj. at 28:9-25 (reasons include possible disruption of recharge and integrated nature of the
Company’s water and wastewater systems).

1 offer credible, substantial evidence of its own. Therefore, its recommendation to set the
2 effluent rate higher than the irrigation rate should be rejected.

3 **C. Staff's BMPS Are Unnecessary**

4 1. Brief Statement of the Issue in Dispute

5 Staff recommends that the Company file 7 BMPs in its tariff and do so in
6 Staff's preferred format. But the Company is already subject to water
7 conservation requirements imposed by ADWR, which requirements include
8 the adoption and implantation of 5 BMPs and a PEP (public education
9 program). There is no evidence that additional regulation is necessary;
therefore, there is no basis for the Commission to order duplicative and
excessive regulation.

10 2. Analysis and Argument

11 Pima has a fully functioning water conservation program that includes 5 BMPs and
12 a customer education program as mandated by the ADWR.²⁶⁴ Pima is already required to
13 file reports on all of its water conservation efforts with ADWR.²⁶⁵ Pima is in compliance
14 with ADWR's requirements.²⁶⁶ Accordingly, Pima does not believe it is necessary for the
15 Commission to impose water conservation requirements.²⁶⁷

16 Staff understands the Company's concern.²⁶⁸ The Company is subject to and
17 complies with ADWR by implementing its BMPs. The Company simply does not want to
18 be required to have more than one agency imposing water conservation regulations.²⁶⁹

19 _____
20 ²⁶⁴ Tr. at 27:13-21; Jones Dt. at 5:3-24. *See also* Scott Dt., Exhibit MSJ at 5 – 6.

21 ²⁶⁵ Tr. at 28:17-20.

22 ²⁶⁶ Tr. at 417:12-15; Scott Dt., Exhibit MSJ at 5 – 6.

23 ²⁶⁷ It is not clear that adoption of Staff's recommendation is legally appropriate. Article 15, § 3 of
24 Arizona's Constitution provides the Commission the power to make orders for the "convenience" and
"comfort" of the customers. A.R.S. § 40-321(A) further provides that, with respect to public utility
25 facilities, the Commission can determine what plant is "just, reasonable, adequate or sufficient" and
enforce such determination by order. There is simply no evidence of the need for a Commission order
imposing additional water conservation regulation.

26 ²⁶⁸ Tr. at 420:7-11.

²⁶⁹ *Id.* *See also* Tr. at 28:21 – 29:1.

1 Staff agrees that customers already have notice of the Company's BMPs,²⁷⁰ and Staff does
2 not suggest that additional regulation of water conservation is necessary because of
3 something Pima has done or not done.²⁷¹ Actually, Staff's position appears to be based on
4 little more than in some cases the Commission has ordered BMPs.²⁷² That is simply not a
5 sufficient justification.

6
7 CONCLUSION

8 Based on the foregoing, Pima respectfully requests the following relief:

- 9 a. A finding that the fair value of Pima's property devoted to water and
10 wastewater service is \$9,122,677 and \$9,894,162, respectively;
- 11 b. Approval of an overall rate of return on such rate base equal to 8.29 percent;
- 12 c. A determination of a revenue requirement for Pima's water and wastewater
13 divisions of \$2,717,184 and \$3,522,034, respectively, which constitute increases over
14 adjusted test year water revenues of \$739,556 or 37.4 percent, and \$425,259 or
15 13.73 percent, over the test year;
- 16 d. Approval of a Rate Case Expense monthly surcharge in the amount of \$0.41
17 per customer bill per division;
- 18 e. Approval of rates for water and wastewater utility service designed to allow
19 the Company to recover such revenue requirement; and
- 20 f. For such other and further relief as the Commission deems appropriate to
21 implement the relief requested herein.

22
23
24 _____
²⁷⁰ Tr. at 418:9-13.

25 ²⁷¹ Tr. at 417:12-15. *See also* Scott Sb. at 4:23 – 5:3.

26 ²⁷² Tr. at 27:22 – 28:3.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

RESPECTFULLY SUBMITTED this 3rd day of July, 2012.

FENNEMORE CRAIG, P.C.

By Jay L. Shapiro
3003 North Central Avenue, Suite 2600
Phoenix, Arizona 85012
Attorneys for Pima Utility Company

ORIGINAL and thirteen (13) copies
of the foregoing were filed
this 3rd day of July, 2012, with:

Docket Control
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Copy of the foregoing hand-delivered
this 3rd day of July, 2012, to:

Teena Jibilian, ALJ
Hearing Division
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Robin Mitchell, Esq.
Scott Hesla, Esq.
Legal Division
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Daniel W. Pozefsky
RUCO
1110 W. Washington Street, Suite 220
Phoenix, AZ 85007

By: *Marcia San Jose*