ORIGINAL

OPEN MEETING ITEM

COMMISSIONERS
GARY PIERCE - Chairman
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PAUL NEWMAN
BRENDA BURNS

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Executive Director

ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission
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SEP 28 2012
DOCKETED BY

DATE: SEPTEMBER 28, 2012

DOCKET NOS.: W-02199A-11-0329 and SW-02199A-11-0330

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Teena Jibilian. The recommendation has been filed in the form of an Opinion and Order on:

PIMA UTILITY COMPANY
(RATES)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00** p.m. on or before:

OCTOBER 9, 2012

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

OCTOBER 16, 2012 AND OCTOBER 17, 2012

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602) 542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

GARY PIERCE - Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

IN THE MATTER OF THE APPLICATION OF PIMA UTILITY COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT 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 PLANT AND PROPERTY AND FOR INCREASES IN ITS WASTEWATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO. SW-02199A-11-0330 DECISION NO. ____________ **OPINION AND ORDER**

DATES OF HEARING:	May 24, 2012 (Pre-hearing Conference); May 29 and July 10, 2012 (Sun Lakes, Arizona) (Public Comments); May 30, 31 and June 1, 2012.
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Teena Jibilian
APPEARANCES:	Mr. Jay L. Shapiro, FENNEMORE CRAIG, P.C., on behalf of Applicant; Mr. Daniel W. Pozefsky, Chief Counsel, on behalf of the Residential Utility Consumer Office; and Ms. Robin Mitchell and Mr. Wesley Van Cleve, Staff Attorneys, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

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BY THE COMMISSION:

I. PROCEDURAL HISTORY

On August 29, 2011, Pima Utility Company ("Pima" or "Company") filed with the Arizona Corporation Commission applications for rate increases in both its water and wastewater divisions, based on a test year ending December 31, 2010.

On September 29, 2011, the Commission's Utilities Division ("Staff") filed a Letter of Sufficiency in each of the dockets, notifying the Company that the applications were deemed sufficient pursuant to Arizona Administrative Code ("A.A.C.") R14-2-103, and classifying Pima as a Class B utility.

On September 30, 2011, a Rate Case Procedural Order was issued, consolidating the applications for purposes of hearing, setting a hearing on the consolidated applications, and setting associated procedural deadlines.

On December 9, 2011, Pima filed a Notice of Filing Certification of Publication and Proof of Mailing, indicating that the public notice required by the Rate Case Procedural Order had been accomplished.

Intervention was granted to the Residential Utility Consumer Office ("RUCO"). No other requests for intervention were filed.

The hearing convened on May 29, 2012, as scheduled, for the purpose of taking public comment. The evidentiary hearing commenced as scheduled before a duly authorized Administrative Law Judge of the Commission on May 30, 2012, and concluded on June 1, 2012.

Because a number of public comments were filed in opposition to the proposed rate increases, the Commission scheduled a local public comment session, which was publicly noticed by Pima and was held by the Commissioners in Sun Lakes, Chandler, Arizona on July 10, 2012.

Following the filing of Initial and Reply Post-Hearing Briefs, the matter was taken under advisement.

II. APPLICATION

A. Pima

Pima is a Class B water and wastewater utility provider to Sun Lakes, a community located in

Chandler, Arizona, developed by Robson Communities, Inc. ("RCI").[1] Pima was formed in 1972 to provide water and wastewater utility services to the unincorporated master planned community of Sun Lakes. Pima also provides water and wastewater utility service to two subdivisions adjacent to Sun Lakes, Oakwood Hills and San Tan Vista.

Pima's current rates and charges for water utility service were approved in Commission Decision No. 58743 (August 11, 1994) using a test year ending December 31, 1992. For wastewater utility service, Pima's current rates and charges were approved in Commission Decision No. 62184 (January 5, 2000), using a test year ending December 31, 1997. During the test year, Pima served approximately 10,175 water connections and 10,051 wastewater connections.

B. Summary of Revenue Recommendations

Pima's proposed revenues and the revenue recommendations of the parties are as follows:

1. Water

Pima proposes a revenue requirement for the water division of $2,717,184, which is an increase of $739,557, or 37.40 percent, over its adjusted test year revenues of $1,977,627. Pima's proposal would result in an approximate $3.28 increase for the average usage (6,395 gallons per month) 5/8 x 3/4 inch meter residential customer, from $10.66 per month to $13.94 per month, or approximately 30.77 percent.

RUCO recommends a revenue requirement for the water division of $2,419,407, which is an increase of $441,780, or 22.34 percent, over its adjusted test year revenues of $1,977,627. RUCO's recommendation would result in an approximate $1.33 increase for the average usage (6,395 gallons per month) 5/8 x 3/4 inch meter residential customer, from $10.66 per month to $11.99 per month, or approximately 12.48 percent.

Staff recommends a revenue requirement for the water division of $2,434,827, which is an increase of $457,200, or 23.12 percent, over its adjusted test year revenues of $1,977,627. Staff's recommendation would result in an approximate $1.54 increase for the average usage (6,395 gallons

[1] RCI provides accounting and administrative services to a group of affiliate companies, which includes the following water and wastewater utilities: Lago Del Oro Water Company; Ridgeview Utility Company; Saddlebrooke Utility Company; Quail Creek Water Company, Inc.; Picacho Water Company; Picacho Sewer Company; Mountain Pass Utility Company; Santa Rosa Water Company; and Santa Rosa Utility Company. Direct Testimony of Company witness Steven Soriano (Exh. A-4) at 1-2.

per month) 5/8 x 3/4 inch meter residential customer, from $10.66 per month to $12.20 per month, or approximately 14.45 percent.

The revenue requirement authorized herein for the water division is $2,397,616, which is an increase of $419,989, or 21.24 percent, over adjusted test year revenues of $1,977,627. The rates approved herein will result in an approximate $1.30 increase for the average usage (6,395 gallons per month) 5/8 x 3/4 inch meter residential customer, from $10.66 per month to $11.96 per month, or approximately 12.2 percent.

2. <u>Wastewater</u>

Pima proposes a revenue requirement for the wastewater division of $3,522,034, which is an increase of $425,259, or 13.73 percent, over its adjusted test year revenues of $3,096,775. Pima's proposal would result in an approximate $3.36 increase for 5/8 x 3/4 inch meter residential customers, from $22.73 per month to $26.09 per month, or approximately 14.78 percent.

RUCO recommends a revenue requirement for the wastewater division of $3,198,757, which is an increase of $101,982, or 3.29 percent, over its adjusted test year revenues of $3,096,775. RUCO's recommendation would result in an approximate $0.73 increase for 5/8 x 3/4 inch meter residential customers, from $22.73 per month to $23.46 per month, or approximately 3.21 percent.

Staff recommends a revenue requirement for the wastewater division of $3,225,350, which is an increase of $128,575, or 4.15 percent, over its adjusted test year revenues of $3,096,775. Staff's recommendation would result in an approximate $1.18 increase for 5/8 x 3/4 inch meter residential customers, from $22.73 per month to $23.91 per month, or approximately 5.19 percent.

The revenue requirement authorized herein for the wastewater division is $3,232,213, which is an increase of $135,438, or 4.37 percent, over adjusted test year revenues of $3,096,775. The rates approved herein will result in an approximate $1.24 increase for 5/8 x 3/4 inch meter residential customers, from $22.73 per month to $23.97 per month, or approximately 5.5 percent.

III. <u>RATE BASE</u>

A. Rate Base Issues

All parties agree on a rate base of $9,122,677 for Pima's water division. The Company and RUCO are in agreement on wastewater rate base of $9,894,162, while Staff recommends a wastewater rate base of $9,646,467. The rate base determination herein is $9,122,677 for Pima's water division, and $9,895,103 for the wastewater division.

1. Previously Unrecorded 1994-1996 Plant Additions

RUCO recommended removal from wastewater plant in service of $37,858 in previously unrecorded 1994-1996 plant additions which were not included in the Company's 1997 test year rate case filing.[2] While Staff did not adopt this adjustment, Staff did not argue against it. The Company agrees to the adjustment in order to eliminate issues between the parties,[3] and it will be adopted.

2. Wastewater Treatment Facility Capacity

The Company's wastewater treatment facility has a designed and permitted capacity of 2.4 million gallons per day ("MGD") maximum.[4] The treatment facility was built in two phases. The first phase included capacity of 1.6 MGD, which was included in rate base in Decision No. 62184.[5] At the time of the rate case leading to Decision No. 62184, Phase 2, which added 0.8 MGD of capacity to the facility, was still under construction.[6] Phase 2 of the wastewater treatment facility came online in 1998,[7] and the Company has requested that it be included in rate base for the first time in this case.[8] RUCO includes the addition of Phase 2 in its proposed schedules.

Staff recommends an excess capacity downward adjustment of $598,468 to wastewater plant in service, to remove the Company's 1998 Phase 2 capacity addition of 0.8 MGD to the wastewater treatment facility.[9] After the standard ratemaking deductions to Staff's resulting plant in service balances, Staff's recommendation results in a wastewater rate base $247,695 lower than that proposed by the Company and RUCO.

Staff's engineering witness testified that during the test year, the highest average daily flow for the wastewater treatment facility occurred in March, 2010, at 1.23 MGD, and that the highest

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[2] Direct Testimony of RUCO witness Timothy J. Coley (Exh. R-5) at 10-11. According to RUCO, over 90 percent of the plant additions would have been fully depreciated by 2010.

[3] Direct Testimony of Company witness Thomas J. Bourassa (Exh. A-8) at 7; Company Final Schedule B-2, p. 3 (wastewater).

[4] Tr. at 33, 34.

[5] Direct Testimony of Staff witness Marlin Scott, Jr. (Exh. S-6) at Exhibit MSJ p. 18.

[6] Surrebuttal Testimony of Staff witness Marlin Scott, Jr. (Exh. S-7) at 3-4.

[7] Direct Testimony of Company witness Ray L. Jones (Exh. A-1) at 7.

[8] Tr. at 45-46.

[9] Direct Testimony of Staff witness Crystal Brown (Exh. S-5) at 12 and Exhibits CSB-3 and CSB-4, Staff Final Schedules (wastewater) CSB-3.

peak day flow was 1.438 MGD, in January, 2010.[10] During the test year, the Company served a total of 10,051 wastewater service laterals.[11] Staff's witness testified that the 1.43 MGD peak day flow translates to 143 gallons per day ("GPD") per service lateral, and that based on the test year flows, at the expected build-out customer count of 10,135, the system should experience a peak day flow of 1.45 MGD, and that based on test year flows, the water treatment facility's 2.4 MGD capacity could serve approximately 16,780 service laterals.[12] Staff states that the wastewater treatment facility has more than enough capacity at 1.6 MGD, and that when capacity of plant exceeds what is reasonable, ratepayers should not be required to provide a return on the excess.[13]

The Company disagrees with Staff's plant disallowance recommendation, asserting that Phase 2 of its wastewater treatment plant is necessary, used and useful, and is serving existing customers.[14] The Company states that the requirements for capacity were established not by the Company or the developer, but by the Arizona Department of Environmental Quality ("ADEQ") and Maricopa County.[15] Pima asserts that if Phase 2 had not been constructed, many of the homes and businesses it serves could not have been built.[16] The Company argues that the facility was designed, permitted and constructed to serve Pima's existing customers, and that the usual concern in an excess capacity situation, that of intergenerational inequities, is therefore not present.[17] The Company asserts that customers in Sun Lakes could not have obtained or received service without the funding and construction of Phase 2, as ordered by ADEQ.[18]

Pima states that actual flows to the wastewater treatment plant are subject to significant annual variation. Pima asserts that recent reduced flows have resulted from the economic downturn, more one-occupant households at present, and water conservation,[19] and argues that flows may increase above the low peak test year level at any time.[20] Pima's witness testified that since Phase 2

[10] Direct Testimony of Staff witness Marlin Scott, Jr. (Exh. S-6) at Exhibit MSJ p. 18.
[11] Direct Testimony of Staff witness Marlin Scott, Jr. (Exh. S-6) at Exhibit MSJ p. 18, Table WW-8.
[12] Direct Testimony of Staff witness Marlin Scott, Jr. (Exh. S-6) at Exhibit MSJ p. 18.
[13] Staff Initial Closing Brief ("Staff Br.") at 4; Staff Reply Closing Brief ("Staff Reply Br.") at 2.
[14] Company Initial Closing Brief ("Co. Br.") at 7.
[15] Co. Br. at 7; Rejoinder Testimony of Company witness Ray L. Jones (Exh. A-3) at 5.
[16] *Id.*
[17] Co. Br. at 7; Rejoinder Testimony of Company witness Ray L. Jones (Exh. A-3) at 7-8.
[18] Co. Br. at 8.
[19] Co. Br. at 8, citing to Tr. at 36, 43.
[20] Co. Br. at 8, citing to Tr. at 425.

of the facility came online, actual wastewater flows treated have ranged from a high peak day of 2.2 MGD[21] to the low peak day of 1.438 MGD during the test year.[22]

Staff argues that where plant is not yet being used for the benefit of ratepayers, the cost of the plant cannot be included in rate base.[23] We agree with this premise. However, the evidence shows in this instance that Pima's Phase 2 capacity has been used, and continues to be used, for the benefit of ratepayers connected to the plant. As the Company argued, even if Pima had not been required to build Phase 2 when it did, it would have had to build it eventually under ADEQ guidelines.[24] ADEQ generally requires a utility to begin planning for additional capacity when a wastewater treatment plant is operating at 80 percent of capacity, and to build the additional capacity when wastewater flows reach 90 percent of capacity.[25] In each of the last six years, Pima's peak day wastewater flows exceeded 80 percent of the Phase 1 1.6 MGD capacity.[26] Pima's actual peak day flows have exceeded 1.6 MGD in two of the past six years.[27] The test year peak day flow was only 1.438 MGD. While this peak day flow was the lowest Pima has experienced since the completion of Phase 2 in 1998, in the following year, 2011, flows again exceeded 90 percent of the Phase 1 1.6 MGD, with a high peak day of 1.517 MGD.[28] Under the specific facts of this case, we find that both Phase 1 and Phase 2 are used and useful, and eligible for inclusion in Pima's rate base.

3. Advances in Aid of Construction (AIAC) and Contributions in Aid of Construction (CIAC)

Based on a post-hearing filing by the Company following discussion of the issue during the hearing,[29] all parties made adjustments to their Final Schedules to reflect the impact of known and measurable post-test year refund payments made by Pima to Meritage Homes pursuant to water and wastewater line extension agreements between Pima and MTH-Hancock, Meritage Homes'

[21] Tr. at 33 (the date of the high peak day flow was not provided by the witness).
[22] Rebuttal Testimony of Company witness Ray L. Jones (Exh. A-2) at 7 (Table 1).
[23] Staff Reply Br. at 2.
[24] *See* Co. Br. at 9.
[25] Tr. at 424.
[26] *Id.*
[27] Rebuttal Testimony of Company witness Ray L. Jones (Exh. A-2) at 7 (Table 1); Surrebuttal Testimony of Staff witness Marlin Scott, Jr. (Exh. S-7) at Figure 3.
[28] Rebuttal Testimony of Company witness Ray L. Jones (Exh. A-2) at 7 (Table 1).
[29] Pima's June 20, 2012 Notice of Filing Late Filed Exhibits.

predecessor in interest.[30]

In its Initial Closing Brief, Staff notes that for Pima's wastewater division, Staff's recommended accumulated amortization of CIAC balance of $24,037 differs from the Company's proposed balance of $22,995, by $1,042.[31] The adjustment proposed by RUCO is also $22,995.[32] The difference in accumulated depreciation computations is due to the parties' use of different amortization rates.[33] The Company and RUCO did not address this issue in their Initial or Reply Closing Briefs. The CIAC amortization rate methodology used by Staff is reasonable and will be adopted. With the other adjustments adopted in this Decision, the correct amortization rate, for both 2009 and 2010, is 5.2312 percent, for total additional amortization of $23,936, and total amortization of CIAC of $602,028.

B. Fair Value Rate Base Summary

Pima did not prepare schedules showing the elements of Reconstruction Cost New Rate Base ("RCND"). Pima agrees that its Original Cost Rate Base ("OCRB") should be treated as its Fair Value Rate Base ("FVRB").[34] Based on the discussion of rate base issues set forth above, we find Pima's FVRB to be $9,122,677 for its water division and $9,895,103 for its wastewater division.

IV. OPERATING INCOME

A. Test Year Revenues

The parties agreed that Pima's adjusted test year revenues were $1,977,627 for its water division and $3,096,775 for its wastewater division, and these amounts will be adopted.

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[30] Co. Final Schedule B-2, page 2 (water); Co. Final Schedule B-2, pages 2 and 5 (wastewater); RUCO Revised Final Schedule TJC-5; RUCO Final Schedule RBM-3; Staff Final Schedule CSB-2 (water); Staff Final Schedules CSB-2 and CSB-8 (wastewater).

[31] Staff Br. at 5, citing to Staff Final Schedule CSB-8 (wastewater). *See also* Pima's June 20, 2012 Notice of Filing Late Filed Exhibits at Exhibit 4.

[32] RUCO Initial Post-Hearing Brief ("RUCO Br.") at 25; RUCO Revised Final Schedule TJC-5.

[33] For this adjustment, the Company and RUCO used CIAC amortization rates for 2009 of 5.0154 percent and for 2010 of 5.0304 percent. Pima's June 20, 2012 Notice of Filing Late Filed Exhibits at 5 and RUCO Revised Final Schedule TJC-5. Staff used a CIAC amortization rate for 2009 and 2010 of 5.2532 percent. Staff Final Schedules CSB-2 and CSB-8 (wastewater).

[34] Co. Br. at 6.

B. Test Year Operating Expenses

The parties recommend total adjusted test year operating expenses as follows:

	Water	Wastewater
Pima	$1,750,188	$2,580,632
RUCO	$1,722,730	$2,447,413
Staff	$1,735,381	$2,490,495

The differences in the parties' recommendations are due to disagreements on Salary and Wage Expense, Depreciation Expense, Rate Case Expense, and Income Tax Expense, each of which are discussed below.

1. <u>Salary and Wage Expense, Officers and Directors Salary</u>

For Mr. Edward Robson, Pima's Chairman/CEO,[35] Pima proposes a total annual Officers and Directors salary of $80,396.[36] RUCO proposes a total annual Officers and Directors salary of $14,170, and Staff proposes total Officers and Directors salary of $27,372.[37]

The Company proposed in its application that Mr. Robson's board-approved compensation of $180,588 be recognized for ratemaking purposes.[38] In data responses, the Company subsequently reported that during the test year, Mr. Robson worked 56.68 hours for the water division and 56.68 hours for the wastewater division.[39] In prefiled rebuttal testimony, the Company's witness Mr. Soriano stated that the schedule Pima provided to the parties indicating the number of hours recorded in the payroll system for each employee does not accurately reflect the hours Mr. Robson spent on Pima, and that Mr. Robson does not keep hourly timesheets.[40]

a. Pima

The Company states that after it mistakenly reported the number of hours Mr. Robson worked during the test year, in an attempt to compromise with RUCO and Staff, the Company proposed a

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[35] Co. Br. at 11. Mr. Robson is also Chairman of Pima's Board of Directors. Pima shares a Board of Directors with its parent company, RCI.

[36] Co. Br. at 11.

[37] The parties' proposed salary amounts are divided equally between the water division and the wastewater division.

[38] Tr. at 58; Co. Final Schedule C-1, p. 2.1 (water) and Co. Final Schedule C-1, p. 2.1 (wastewater). The application requested a salary of $90,294 for each division.

[39] Exhibit R-2 (copies of data responses provided by the Company in November 2011 and February 2012).

[40] Rebuttal Testimony of Company witness Steven Soriano (Exh. A-5) at 8-9; Tr. at 57.

salary expense level for ratemaking that is below Mr. Robson's actual salary.[41] The Company arrived at its $80,396 salary proposal for Mr. Robson by beginning with the CEO salary authorized for Pima's wastewater division in Decision No. 62184[42] after the Company filed a wage study in that case,[43] and grossing it up for inflation and the increased number of customers Pima serves.[44] The Company states that it does not know the exact number of hours Mr. Robson worked for Pima during the test year, but that it is basing his salary expense on the value he brings to the Company instead.[45] The Company argues that no evidence was submitted to suggest that Mr. Robson's role with Pima has changed since his salary was found reasonable and authorized in Decision No. 62184, and that the Company's proposal is therefore reasonable and supported by substantial evidence.[46]

b. RUCO

RUCO states that it is not persuaded by the Company's compromise salary request of $80,396.[47] RUCO argues that the Company has not presented any proof to show the value of Mr. Robson's services to Pima upon which its compromise is based, and that the request should therefore be rejected.[48] RUCO further argues that the Company has not presented evidence showing how Mr. Robson's services to Pima are distinguished from services provided to the other utilities Mr. Robson operates.[49] RUCO asserts that the fact that Mr. Robson allocates his time among many RCI utilities without taking a salary from them[50] raises the concern that Pima's ratepayers will be subsidizing Mr. Robson's time devoted to his other businesses.[51]

RUCO bases its recommendation of $14,170 for total Officer and Director Salary expense for Pima on $125 per hour, times the 113.36 total test year hours the Company reported on the data

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[41] Co. Br. at 13.
[42] According to evidence offered by Pima during this hearing, Pima requested a salary for its CEO of $19,875 for the wastewater division in that rate case. Exhibit A-17. The Commission accepted Pima's total wages expense in that case. Decision No. 62184 at 11.
[43] Company Reply Closing Brief ("Co. Reply Br.") at 6.
[44] Rebuttal Testimony of Company witness Steven Soriano (Exh. A-5) at 9.
[45] Co. Br. at 13.
[46] Co. Br. at 12-13, 16-17.
[47] RUCO Br. at 18.
[48] RUCO Reply Closing Brief ("RUCO Reply Br.") at 16.
[49] *Id.*
[50] RUCO Br. at 19, citing to Tr. at 67-68, 84.
[51] RUCO Br. at 19.

response.[52] RUCO acknowledges that the Company later testified that the number of hours it reported in the data response was inaccurate, but RUCO maintains that its recommendation is fair under the facts of this case.[53] RUCO states that its use of an hourly rate of $125 is based on the CEO salary for Arizona Water Company in 2008.[54] RUCO argues that Pima's initial large salary request, Pima's reporting mistake, and Pima's lack of any timekeeping or verifiable means to support the salary request, all support RUCO's position that the Company's proposal should be rejected.[55]

c. Staff

Staff does not agree with the Company's method of calculating salary expense for Mr. Robson, because there was no evidence that his salary in the prior rate case was based on time sheets or any documentation or record.[56] Staff's witness states that the work performed by the Chairman of the Board for Pima is classified as indirect, and not direct, for National Association of Regulatory Commissioners ("NARUC") accounting purposes, because it reflects the oversight of RCI which in turn, oversees Pima.[57] Like RUCO, Staff points out that while Mr. Robson performs duties for other RCI affiliate utilities, he is not compensated with a salary by those utilities.[58] Staff's witness explained that NARUC principles require indirect costs to be allocated, in order to avoid shifting the costs of the unregulated entity [RCI] to the captive customers of the regulated utility [Pima].[59] Staff's witness testified that such cost shifting results in the captive customers of the regulated utility subsidizing the business operations of the unregulated affiliate, which harms customers by creating artificially higher rates.[60] Staff therefore calculated an allocated salary expense for Mr. Robson's work for Pima by multiplying total RCI employee salary and wage expense by 30 percent, for total Officer and Director Salary expense for Pima of $27,372.[61] Staff believes that its recommendation is reasonable and should be adopted.[62]

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[52] *Id.*
[53] *Id.* at 18, 19.
[54] RUCO Reply Br. at 16.
[55] RUCO Br. at 19.
[56] Surrebuttal Testimony of Staff witness Crystal S. Brown (Exh. S-10) at 5.
[57] Direct Testimony of Staff witness Crystal S. Brown (Exh. S-5) at 16.
[58] Staff Br. at 6. *See* Tr. at 67-68, 84, 88.
[59] Direct Testimony of Staff witness Crystal S. Brown (Exh. S-5) at 16.
[60] *Id.*
[61] *Id.* at 17.
[62] Staff Br. at 6.

d. Discussion and Conclusion

The Company believes that RUCO's analysis is flawed because it did not explain how it used the salary of the President of Arizona Water Company to determine an hourly rate of $125, and because it is based on an erroneous number of hours, as stated in the testimony of Pima's witness Mr. Soriano.[63] Pima asserts that RUCO relied on erroneous and unsupported information to reach its recommendation, and argues that the mistake Pima made in its data response regarding the number of hours Mr. Robson worked does not justify use of the erroneous number to calculate Mr. Robson's salary expense.[64]

Pima asserts that the Commission has approved a salary for Mr. Robson as part of Pima's operating expenses in a previous rate case after the Company filed a wage study.[65] The Company argues that Staff's recommended salary level is therefore not justified,[66] and that Staff does not offer any substantial evidence on the issue.[67] We disagree. In this case, the evidence is clear that Pima's CEO performs duties for the other RCI affiliate utilities, while receiving no salary compensation from those utilities.[68] Decision No. 62184 approved the Pima wastewater division CEO salary as a part of total proposed salary and wage expense, with no discussion of the individual CEO salary, or of the wage study.[69] Pima argues that the allocated salary recommended by Staff for Pima's CEO is "unreasonably low." However, the remedy for any failure of the other utilities in the RCI family of companies to properly compensate Mr. Robson for his duties is not to have Pima's customers subsidize the expenses of the other utilities in Pima's rates.

Based on the evidence presented, the Company's proposed total annual Officers and Directors salary of $80,396 is excessive. We find that in the absence of accurate time records, Staff's recommended salary level of $27,372, which Staff reached by allocating Mr. Robson's salary using

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[63] Co. Br. at 14.
[64] *Id.* at 15.
[65] *Id.* at 15-16, citing to Tr. at 463.
[66] Co Br. at 15
[67] Co. Reply Br. at 6.
[68] *See* Tr. at 67-68, 84, 88.
[69] Decision No. 62184 at 11. Likewise, the excerpt of direct testimony of a witness for Pima in the rate case leading to Decision No. 62184 offered by Pima during this hearing, Exhibit A-17, makes no mention of the fact that Pima's CEO performs duties for the other utilities in the Robson family of utilities, while receiving no salary compensation from those utilities.

NARUC cost causation principles and cost drivers, reasonably and appropriately avoids cost-shifting from other RCI affiliates to Pima's customers, and we will adopt it, along with the corresponding adjustments to pension and benefit expense.

2. Depreciation Expense

RUCO made a minor adjustment to the Company's proposed depreciation expense in its water division. While all parties came to agree on plant in service balances for the water division, including an adjustment that moved some plant items from expenses to plant in service, RUCO calculated depreciation expense associated with that adjustment differently from the Company and Staff.[70] RUCO reclassified the plant into different plant categories than did the Company and Staff, which resulted in a difference of $550 in depreciation expense due to the differences in applied depreciation rates.[71] While all three parties used the same depreciation rates,[72] RUCO's plant classifications, which were based on Company data responses, differed slightly from the Company's and Staff's.[73] RUCO's recommended total depreciation expense for the water division is $688,937, whereas the Company and Staff's is $688,387.[74] Neither the Company nor Staff responded in their Reply Closing Briefs to this issue. RUCO's adjustment to Pima's water division depreciation expense is reasonable and will be adopted, for total depreciation expense of $688,937.

3. Rate Case Expense

a. Amount

Pima proposes rate case expense of $200,000 for the water division and $200,000 for the wastewater division.[75]

RUCO recommends rate case expense of $150,000 per division.[76] RUCO based its recommendation on an analysis comparing rate case expense awarded in other utility rate cases and

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[70] RUCO Br. at 17, citing to Tr. at 142-43.

[71] Tr. at 143; RUCO Final Schedule RBM-10; Company Final Schedule C-2, page 2 (water); Staff Final Schedule CSB-16 (water).

[72] *Id.*

[73] Tr. at 143.

[74] *Id.*; RUCO Final Schedule RBM-10; Company Final Schedule C-2, page 2 (water); Staff Final Schedule CSB-16 (water).

[75] Co. Br. at 17, 19-20; Direct Testimony of Company witness Thomas J. Bourassa (Exh. A-6) at 12-14.

[76] Direct Testimony of RUCO witness Timothy J. Coley (Exh. R-5) at 22; Direct Testimony of RUCO witness Robert B. Mease (Exh. R-3) at 14.

on RUCO and Staff recommendations in a rate case pending at the time of RUCO's analysis.[77]

Staff recommends that Pima be authorized its requested $400,000 in rate case expense.[78]

Pima is critical of RUCO's choice of comparable utilities for its evaluation of Pima's proposed rate case expense.[79] Pima points out that one of the comparison utilities RUCO used, Sunrise Water Company, provides only water service and has a much smaller customer base than Pima, and that two other comparison utilities RUCO used, Arizona Water Company and UNS Gas, have in-house rate staff and in-house legal staff that provide support for rate cases.[80]

b. Means of Recovery

Pima originally proposed that its rate case expense be recovered over four years, or $50,000 annual rate case expense for each division.[81] In its rebuttal testimony, however, Pima proposed that one of RUCO's alternative recommendations be adopted, which would allow Pima to recover its rate case expense by means of a surcharge.[82] Pima proposes that the surcharge be calculated by taking the authorized amount of rate case expense and determining how much needs to be collected from each customer each month for a five year period (60 months).[83] Pima's proposed surcharge would cease when the authorized amount of rate case expense is recovered, such that the Company would recover the exact amount of authorized rate case expense.[84] Pima estimates that based on the year-end number of 10,188 customers, the surcharge would be $0.33 per monthly customer bill per division.[85] The Company states that rate case expense has no impact on the matching of plant, expenses, revenues, and customers, because it is a prepaid expense incurred mostly outside the test year, and it

[77] RUCO Br. at 20-21, citing to Direct Testimony of RUCO witness Timothy J. Coley (Exh. R-5) at 23-24. Mr. Coley's analysis included Decision No. 64282 (December 28, 2001) (Arizona Water Company), Decision No. 66849 (March 19, 2005) (Arizona Water Company), Decision No. 68302 (November 14, 2005) (Arizona Water Company), Decision No. 71445 (December 23, 2009) (Sunrise Water Company), and Docket No. G-04204A-11-0158 (UNS Gas).

[78] Staff Br. at 6; Staff Final Schedule CSB-7, page 1 (water); Staff Final Schedule CSB-10, page 1 (wastewater).

[79] Co. Br. at 17-18.

[80] *Id.*, citing to Rebuttal Testimony of Company witness Thomas J. Bourassa (A-8) at 16 and Tr. at 347.

[81] Direct Testimony of Company witness Thomas J. Bourassa (Exh. A-6) at 12-14.

[82] Rebuttal Testimony of Company witness Steven Soriano (Exh. A-5) at 4; Rebuttal Testimony of Company witness Thomas J. Bourassa (A-8) at 15.

[83] Co. Br. at 20.

[84] *Id.*, citing to Rebuttal Testimony of Company witness Steven Soriano (Exh. A-5) at 4 and Rebuttal Testimony of Company witness Thomas J. Bourassa (A-8) at 15.

[85] Rebuttal Testimony of Company witness Thomas J. Bourassa (A-8) at 15.

will not be incurred during most of the period the rates approved in this Decision will be in effect,.[86] The Company asserts that a rate case expense recovery surcharge is lawful, fair and balanced.[87]

RUCO recommends normalization of rate case expense of $150,000 per division, over four years, for annual rate case expense of $37,500 for each division.[88] RUCO is concerned, however, that the Company may refrain from filing a rate case for many years as it has in the past, and states that it does not believe Pima will file another rate case in the near future, because Pima's service territory is built out.[89] RUCO therefore offered alternative options to prevent over-recovery of rate case expense in the event the Company does not file a rate case for an extended period of time.[90] RUCO proposed three alternatives to its four year normalization recommendation: (1) the implementation of a rate case surcharge, or (2) the implementation of a ten year normalization period with a deferred accounting order to be granted if the Company filed a rate case sooner, or (3) a reduction of rate case expense with no deferred accounting order.[91] Of its three alternative options, RUCO states that it prefers the ten-year normalization period with the deferred accounting order.[92] RUCO asserts that this alternative option would ensure full rate case expense recovery while avoiding any unfavorable customer response to a surcharge.[93]

Staff recommends rate case expense of $200,000 per division, normalized over five years, for annual rate case expense of $40,000 for each division.[94] Staff's witness testified that Staff usually normalizes rate case expense over a three to five year period, and that in this case, because Pima's water division has not been in for a rate case in approximately 18 years, and its wastewater division in approximately 10 years, Staff believes a five year normalization period is appropriate.[95] Staff

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[86] Co. Br. at 20-21; Co. Reply Br. at 9, citing to Rebuttal Testimony of Company witness Thomas J. Bourassa (Exh. A-8) at 13; Rejoinder Testimony of Company witness Thomas J. Bourassa (A-10) at 15.
[87] Co. Reply Br. at 9.
[88] RUCO Br. at 20; RUCO Final Schedule RBM-8 (water); RUCO Revised Final Schedule TJC-8, page 1 (wastewater).
[89] RUCO Br. at 21.
[90] Direct Testimony of RUCO witness Timothy J. Coley (Exh. R-5) at 26-27; Direct Testimony of RUCO witness Robert B. Mease (Exh. R-3) at 19.
[91] Direct Testimony of RUCO witness Timothy J. Coley (Exh. R-5) at 27; Direct Testimony of RUCO witness Robert B. Mease (Exh. R-3) at 19.
[92] RUCO Br. at 23.
[93] *Id.*
[94] Staff Br. at 6; Direct Testimony of Staff witness Crystal S. Brown (Exh. S-5) at 23-24; Staff Final Schedules CSB-7, page 2 and CSB-15 (water); Staff Final Schedules CSB-10, page 2 and CSB-18 (wastewater).
[95] Direct Testimony of Staff witness Crystal S. Brown (Exh. S-5) at 23-24.

states that the Commission has recently adopted a five year normalization period for a utility that had not been in for a rate case in 14 years.[96] Staff states that while there are a few jurisdictions that allow a rate case expense surcharge,[97] and while almost every expense incurred by a utility could potentially be surcharged to customers, Staff believes it is more appropriate to allow Pima to recover its rate case expense through rates.[98] Staff argues that including costs in rates can encourage utilities to find operating efficiencies and economies.[99]

In response to the concern that Pima will stay out longer and would therefore over-recover if the amortization period is set for too short a time period, the Company points out that RUCO's recommendation for the means of recovery is for a typical four-year normalization of rate case expense.[100] Pima argues that RUCO's preferred alternative of a 10 year amortization period would be punitive.[101] Pima asserts that under-recovery of rate case expense is also a concern.[102] The Company asserts that it will need to file for new rates in no more than five years,[103] because it will be building more than $1.5 million of new force main with recently approved debt proceeds,[104] it will need to refinance its recently-approved debt in five years,[105] and customer growth will no longer pay for increased expenses since the community is now built out.[106]

c. Discussion and Conclusion

We find that $200,000 rate case expense per division as proposed by the Company and recommended by Staff is reasonable for this rate case. In a recent Decision, we authorized rates that normalized rate case expense over a three year period, and additionally ordered that once the utility

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[96] Staff Br. at 7, citing Decision No. 72177 (February 11, 2011) (*Sahuarita Water Company, LLC*).

[97] Staff Br. at 7, citing *In the Matter of Hampstead Area Water Company, Inc.*, 94 N.H. P.U.C. 563 (2009) (New Hampshire); *In the Matter of Centerpoint Energy Houston Electric, LLC*, 2005 WL 1668034 (Tex.P.U.C.) (Texas); *KN Energy, Inc. v. City of Scottsbluff*, 233 Neb. 644, 447 N.W. 227 (1989) (Nebraska); *In the Matter of Black Hills/Nebraska Gas Utility Company LLC*, 283PUR4th 384 (2010) (Nebraska) (allowing both a surcharge and amortization of rate case expense over a certain period).

[98] Staff Br. at 7.

[99] *Id.*

[100] Co. Reply Br. at 9.

[101] *Id.*

[102] Co. Br. at 19.

[103] Co. Reply Br. at 8-9, citing to Rebuttal Testimony of Company witness Steven Soriano (Exh. A-5) at 2-3 and Rejoinder Testimony of Company witness Thomas J. Bourassa (A-10) at 17.

[104] Co. Br. at 19, citing to Rebuttal Testimony of Company witness Steven Soriano (Exh. A-5) at 2-3.

[105] Co. Br. at 19, citing to Rebuttal Testimony of Company witness Steven Soriano (Exh. A-5) at 3.

[106] Co. Br. at 19, citing to Direct Testimony of Company witness Steven Soriano (Exh. A-4) at 5.

fully recovered its authorized amount of rate case expense, the recovery would cease, resulting in a lowering of rates.[107] While it is certainly not inappropriate to allow recovery of rate case expense through rates, we find that the Company's adoption of RUCO's alternative recommendation for a surcharge as a means of preventing over-recovery of rate case expense is reasonable in this case. We will therefore authorize Pima to implement a surcharge of $0.33 per customer for the water division, and a surcharge of $0.33 per customer for the wastewater division, with the surcharges remaining in place for either: (1) a period of 60 months, or (2) until Pima has collected $200,000 per division in rate case expense recovery, or (3) until new rates go into effect as a result of a rate case subsequent to this one, whichever occurs sooner.

4. Income Tax Expense

a. Pima

Pima is organized as an S corporation and therefore there are no income tax expenses on its books. Pima requests, however, that an income tax allowance be included in the determination of its revenue requirement.[108] The amount Pima requests is annual expense of $235,132 for the water division and $255,017 for the wastewater division, based on Pima's proposed test year revenues.[109] Pima argues that the income taxes paid by its shareholders are a cost of utility service and should be recovered through rates.[110] Pima asserts that as a policy matter, allowing pass-through entities to recover an allowance for shareholders' income taxes through rates will promote tax efficiency and encourage needed investment, benefitting ratepayers.[111] Pima states that the Federal Energy Regulatory Commission ("FERC") has recently changed its policy regarding the recovery of income tax expense for pass-through entities, and asserts that the Commission should likewise change its policy.[112] Pima presented an expert witness in support of its position, former Commission Chairman and former FERC Commissioner Marc L. Spitzer. During Commissioner Spitzer's FERC tenure,

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[107] *See* Decision No. 72498 (July 25, 2011) (Las Quintas Serenas Water Company) at 9-10.
[108] Co. Br. at 21.
[109] Co. Final Schedule C-1, page 2.2 (water) and Co. Final Schedule C-1, page 2.2 (wastewater).
[110] Co. Br. at 21, 23, citing to Tr. at 261 and 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. The Commission's Decision in that docket, Decision No. 55839 (January 8, 1988) did not adopt Staff's argument.
[111] Co. Br. at 21, 24.
[112] *Id.* at 21.

FERC implemented a policy to allow the pass-through entities it regulates to recover an income tax allowance through rates.

When Pima formed in 1972 it did not make an election to be an S corporation.[113] In 1973, Pima made the election to become an S corporation, and remained an S corporation until 1979.[114] In 1979, Pima stopped making an S corporation election because the shareholders at the time were asked to invest more capital, did not want to be responsible to pay taxes on the income of an entity that was not paying a return, and corporate tax rates were at lower levels than previously seen.[115] In 1986, when the Tax Reform Act of 1986 lowered individual income tax rates below corporate tax rates, Pima once again elected S corporation status, and has remained an S corporation every year since then.[116]

Pima's stated reason for continuing to elect S corporation status since 1986 is that it is the most tax efficient strategy for the Company.[117] Pima states that specific benefits of pass-through entities over C corporations include a lower ultimate tax rate, reduced administrative burden, and the avoidance of double taxation on both income generated from operations and liquidation of assets.[118] Pima argues that this Commission's current policy of not providing an income tax allowance in utility rates to pay the income taxes of pass-through entities' shareholders "punishes" the pass-through entities by forcing them to choose between an inefficient tax structure or the "disallowance" of income tax expense for its shareholders.[119] Pima's witness Mr. Soriano testified that if it is not granted an income tax allowance expense, Pima will have to evaluate whether to remain an S corporation.[120] Pima argues that giving up its tax efficient S corporation election could cost ratepayers more in the long run, both in higher taxes and reduced investment capital.[121]

To support its position that Pima's ratepayers should pay the income tax expense of its shareholders, Pima relies on the argument that the provision of utility service gives rise to an actual

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[113] Tr. at 387-88.
[114] *Id.* at 388.
[115] Co. Br. at 23; Tr. at 389.
[116] Co. Br. at 23; Tr. at 6, 277, 390, 394.
[117] Co. Br. at 23; Tr. at 394.
[118] Co. Br. at 23; Tr. at 179-182, 230; Rebuttal Testimony of Company witness Marc L. Spitzer (Exh. A-12) at 6.
[119] Co. Br. at 24.
[120] Co. Br. at 30, Tr. at 394-95.
[121] Co. Br. at 30.

or potential tax liability, whether the expense is actually incurred by the utility or not.[122] Pima urges that "ratepayers are **not** paying someone else's income taxes--the so-called 'phantom tax' argument is simply a stylish phrase that obfuscates the truth: utility operations (usually) generate taxable income."[123] Pima argues that if its position is adopted, its ratepayers would not be paying "someone else's income taxes" any more than ratepayers are paying Pinnacle West's or Unisources's shareholders' taxes when APS and TEP customers pay rates that include income tax expense.[124] To support its argument that "phantom tax" does not exist, Pima cites to FERC's policy statement, where FERC concluded that "the reality is that just as a corporation has an actual or potential income tax liability on income from the first tier public utility assets it controls, so do the owners of a partnership or LLC on the first tier assets and income that they control by means of the pass-through entity."[125] Pima posits that if income arises from the operation of a utility, then income tax liability is a cost of utility service, and the income tax expense should be recovered in utility rates, regardless of the utility's form of corporate organization.[126]

Pima argues that the fact that Pima itself does not pay income tax is not entirely dispositive of the issue.[127] Pima takes issue with the assertion that Pima's proposal would have rates set on a non-existent operating expense, arguing that the tax liability is real, and that the Commission has the power and discretion to include an income tax allowance in the Company's revenue requirement.[128] In support of its position, Pima points to the Commission's use of hypothetical interest deductions in the determination of a revenue requirement.[129]

Pima asserts that there is no such thing as "phantom tax," as argued by RUCO, because tax liability and tax payment are not the same thing, and there are always other factors that impact the amount of tax paid on income.[130] Pima states that all operating expenses are estimates, based on test

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[122] *Id.* at 24-25.
[123] *Id.* at 24 (emphasis in original).
[124] *Id.* at 24-25.
[125] *Id.* at 25, citing to Rebuttal Testimony of Company witness Marc L. Spitzer (Exh. A-12) at 17 (*quoting* from *Policy Statement on Income Tax Allowances,* 111 FERC ¶ 61,139 (2005)), Exhibit MLS-RB2.
[126] Co. Br. at 25, citing to Tr. at 238.
[127] Co. Br. at 28.
[128] Co. Reply Br. at 13-14.
[129] *Id.* at 14.
[130] Co. Br. at 28.

year amounts and used to build a revenue requirement, and that there is no post rate case true-up of any operating expense to ensure that the utility actually pays the expense amounts included in the revenue requirement.[131] The Company asserts that that Arizona Public Service Company's rates included income tax expense during years when its affiliate Suncor Development Company generated tax losses that reduced or eliminated its parent Pinnacle West Capital Corporation's federal and state income tax payments.[132] Pima asserts that there is no material difference between allowing income tax expense in the revenue requirement for a C corporation that won't actually pay the income tax expense, and including an income tax allowance in rates for a pass-through entity.[133]

The Company asserts that RUCO is using the "phantom tax" argument as a pretext to suppress rates.[134] Pima argues that compelling a regulated utility to waste funds on a tax-inefficient choice of entity with the goal of suppressing rates creates an illusory ratepayer benefit, because it reduces the utility's access to capital.[135] Pima asserts that tax efficient entities are more attractive to investors, and investors fund the infrastructure that benefits customers.[136]

Pima states that a determination that its revenue requirement should include an income tax allowance expense does not end the inquiry, because the amount of the allowance would also have to be determined.[137] Pima advocates that the Commission should determine how much its requested income tax allowance should be using the methodology proposed by its witness Mr. Bourassa.[138] Mr. Bourassa began with the FERC methodology,[139] and proceeded to estimate effective tax rates for Pima's shareholders, individuals and entities, based upon their their proportionate share of income at proposed revenues using federal and state tax rates.[140] Using his methodology, Mr. Bourassa

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[131] *Id.* at 28, 29; Co. Reply Br. at 15.
[132] Co. Br. at 27, 29.
[133] *Id.* at 29.
[134] *Id.* at 27.
[135] *Id.*
[136] Co. Br. at 30 (citing to Tr. at 245-46, 262, 264).
[137] Co. Br. at 30.
[138] *Id.* at 35.
[139] The Company summarizes the FERC methodology as follows:

1. Drill down through all stockholders until a taxable or nontaxable entity is reached;
2. Establish a marginal tax rate for each taxable entity (FERC typically uses presumptive rates of 28 percent for all individual taxpayers and 35 percent for taxable entities); and
3. Calculate a weighted average tax rate for the combined ownership.

Co. Br. at 33.
[140] Co. Br. at 34; Rebuttal Testimony of Company witness Thomas J. Bourassa (Exh. A-8) at 17-18.

concluded that an effective tax rate for Pima's shareholders should be 27.5 percent.[141] The Company states that this methodology results in a lower effective federal tax rate compared to the FERC methodology, and requests that the Commission adopt it.[142]

In response to the suggestion that the Commission should determine an actual effective tax rate for each shareholder,[143] Pima asserts that looking at individual shareholders' tax returns to calculate the proposed allowance is "ludicrous,"[144] for the same reason that the Commission does not base income tax expenses for C corporations on actual tax payments.[145] Pima argues that its shareholders have not been asked for their individual tax returns in this case, and that in any event, the Company does not believe that looking at individual tax returns in a given year would provide a sound basis upon which to base the effective income tax rate, because effective tax rates vary significantly from year to year based on shareholders' other income and deductions.[146] The Company states that the income tax expense of regulated C corporations is never disallowed because of an affiliate loss offsetting income, and asserts that pass-through entities should be treated no differently.[147]

An issue arose during the hearing of whether a Commission policy statement on an income tax allowance is needed. Addressing this issue, Pima states that with or without a policy statement, Pima would still need a rate case in order to have an income tax allowance included in its revenue requirement.[148] The Company argues that this case is the proper forum to decide the issue of income tax allowance expense for pass-through entities, and that a determination should not be put off to some other as yet unknown and undefined proceeding.[149] The Company agrees with Staff that the Commission is not obligated to follow FERC, but believes the reasoning set forth by FERC, as explained by its witness Mr. Spitzer, is persuasive for granting the Company an income tax allowance

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[141] *Id.*
[142] *Id.*
[143] *See* Tr. at 322-323.
[144] Co. Br. at 34, citing to Tr. at 208.
[145] Co. Br. at 34-35; Co. Reply Br. at 16-17.
[146] Co. Reply Br. at 16.
[147] Co. Br. at 35; Co. Reply Br. at 17.
[148] Co. Br. at 32.
[149] *Id.*

expense.[150]

b. RUCO

RUCO asserts that it is difficult to imagine why the Commission would entertain Pima's request that its ratepayers pay the personal income taxes of Pima's shareholders related to Pima's income, when Pima has voluntarily elected not to pay federal or state income tax to avoid double taxation, and when Pima can change its S corporation election at any time if it feels disadvantaged.[151] RUCO argues that having captive ratepayers pay the personal taxes of Pima's shareholders is bad public policy; that the reasons Pima provides to justify increasing rates to cover shareholders' taxes are unpersuasive; and that Pima's proposal would result in rates that are not just and reasonable, in violation of the Arizona Constitution.[152]

RUCO states that Pima's requested income tax allowance expense constitutes over 50 percent of its requested revenue increase for its wastewater division, and 30 percent for its water division.[153] RUCO argues that FERC's new policy has met with criticism from a tax analyst, and that it is not controlling precedent in Arizona.[154] RUCO argues that Commission policy should make sense for Arizona, and that Arizona should not adopt a policy just because FERC has chosen to do so.[155] RUCO points out that the intent behind the FERC policy on income tax recovery for pass-through entities was to encourage investment in desperately needed interstate gas pipelines, and that those circumstances are not present here, with a water utility.[156]

RUCO argues that while it is true that the District of Columbia Court of Appeals upheld the FERC policy to impute income tax to pass-through entities, the policy was upheld only on the ground that FERC had "justified its new policy with reasoning sufficient to survive . . . review," and points out that the court deferred to FERC's ratemaking authority on the wisdom of the policy itself, stating

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[150] *Id.*
[151] RUCO Br. at 1.
[152] *Id.* at 1-2.
[153] *Id.* at 2.
[154] *Id.* at 2-4, citing to the Direct Testimony of RUCO witness William A. Rigsby (Exh. R-9) at Exhibit 1 (Johnston, David Cay, "Master Limited Partnerships: Paying Other People's Taxes" *Tax Notes*, a *Tax Analysts Publication,* June 21, 2010) (stating that investors in master limited partnerships owning a pipeline capture 75 percent more in after-tax profits than if they had invested in a traditional corporation owning a pipeline).
[155] RUCO Br. at 4.
[156] *Id.* at 11. *See* Tr. at 244-46.

"[w]e need not decide whether the Commission has adopted the best possible policy as long as the agency has acted within the scope of its discretion and reasonably explained its actions."[157] RUCO notes that the *Exxon Mobil* court is the same court that had previously, in 2004, struck down FERC's earlier attempt to implement the policy, which the court had characterized as an attempt to ". . . create a phantom tax in order to create an allowance to pass-through to the ratepayer."[158]

RUCO disagrees with the Company's argument that the fact that an S corporation does not pay income taxes is a "technical distinction."[159] RUCO states that Pima's shareholders have taken advantage of the tax benefits conferred by S corporation status, and pay personal income taxes, not corporate taxes, on the income they receive from Pima.[160] RUCO characterizes the Company's request as a "money grab," asserting that despite the preferential tax treatment Pima receives, it wishes its shareholders to avoid all tax liabilities, by having the ratepayers pay them.[161]

RUCO addresses Pima's argument that the personal income taxes its S corporation shareholders pay are the consequence of the income produced by the Company.[162] RUCO states that it cannot support Pima's logic and the natural, obvious extension of that logic, which is that the personal income taxes that C corporation shareholders pay on dividends are also the consequence of the operation of the C corporation utility.[163] RUCO asserts that if the personal income tax liability for S corporation shareholders is considered a legitimate utility expense because the earnings are the consequence of utility operation, then it follows that the personal income tax liability of C corporation shareholders must also be considered a legitimate utility expense.[164] RUCO argues that if Pima's proposal is approved, shareholders of S corporation utilities would effectively not be subject to any taxation on their investment income, while shareholders of C corporation utilities would still be subject to personal income taxation on their dividends.[165] RUCO poses the question whether, if ratepayers of S corporation are held responsible for income tax liability on the income of

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[157] RUCO Br. at 6, citing to *Exxon Mobil Oil Corp. v. FERC.*, 487 F.3rd 945, at 948, 955.
[158] *Id.*, citing to *BP West Coast Products v. FERC*, 374 F.3d 1263, 1291.
[159] RUCO Br. at 7, citing to Rebuttal Testimony of Company witness Marc L. Spitzer (Exh. A-12) at 7.
[160] RUCO Br. at 7.
[161] *Id.* at 7-8.
[162] RUCO Reply Br. at 8-10.
[163] *Id.*
[164] RUCO Reply Br. at 9.
[165] *Id.*

shareholders, ratepayers of C corporation utilities will next be held responsible for the personal income tax resulting from income earned by C corporation shareholders.[166]

RUCO states that it finds no merit the Company's argument that the failure of Arizona utilities set up as pass-through entities to receive an income tax allowance expense creates an impediment to utility investment in Arizona. RUCO states that S corporation status allows utility investors to avoid double taxation, and allows startups to raise capital.[167] RUCO points out that since the 1980's when the Commission began denying utilities' requests for the income tax allowance, there has been an increase in the number of utilities switching to or organizing as S corporations or LLCs.[168] RUCO states that the fact that Pima and other Arizona utilities have thus far been able to meet their infrastructure investment demands while organized as S corporations, despite being precluded from recovering shareholder personal income taxes in rates, belies Pima's argument that this preclusion impedes investment in Arizona.[169]

In response to the Company's contention that having ratepayers cover the personal tax liability of Pima's shareholders would actually save ratepayers money by preventing Pima from becoming a C corporation to recover income taxes in rates, RUCO asserts that there is no evidence in the record to support Pima's contention that utilities are being "pushed" to switch to C corporation status.[170]

RUCO makes an argument that adopting the Company's proposal would violate the Commission's constitutional obligation to consider and protect ratepayers' interests when determining just and reasonable rates.[171] RUCO states that since pass-through entity shareholders may offset tax liability for income earned from Pima with losses from other investments as well as with personal income tax deductions not available to corporations, it is possible that monies collected in rates for shareholder tax liability may exceed the amount of taxes actually owed, which would unjustly enrich the shareholders.[172] RUCO contends that the Company's proposal would result in

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[166] *Id.* at 8-9.
[167] *Id.*
[168] *Id.*
[169] RUCO Br. at 8-10.
[170] *Id.* at 10.
[171] *Id.* at 13-15.
[172] *Id.* at 11-12.

arbitrary rates, because there is no fair way to reconcile the shareholders' personal income tax with a corporate income tax rate to guarantee that ratepayers pay an appropriate and fair amount of income tax, because the calculation of corporate income tax and personal income tax is completely different, with different individual tax rates, and different offsets available.[173] Pointing to Pima's argument that looking at its individual shareholders' returns is "ludicrous,"[174] RUCO asserts that the methodology Pima used to compute its proposed tax rate, without providing the shareholders' actual tax returns or their Schedule K-1 forms, is guaranteed to recover an amount that will be different from the actual income taxes paid by shareholders.[175]

RUCO asserts that the Company's proposal is contrary to Arizona case law, which requires utility revenue to be based on operating costs.[176] RUCO argues that because Pima does not pay income tax, income tax is not part of Pima's operating costs, and therefore Pima's proposal would have rates set on a non-existent operating expense, resulting in rates that are not just and reasonable, and therefore unconstitutional.[177] RUCO also argues that a policy that would allow shareholders to entirely avoid paying personal income tax on the income revenues received from their investment in the utility considers only the shareholders' interests, thus failing to balance the interests of the shareholders and the ratepayers.[178]

c. Staff

Staff states that as a consequence of the Company's S corporation election, Pima does not pay income taxes to the Internal Revenue Service or to the state of Arizona; that it is therefore not appropriate to include income tax expense in the adjusted test year as a known and measurable expense; and that Pima's proposed income tax allowance adjustment should therefore be disallowed.[179] In response to the Company's argument that an actual payment in the amount of the expense is not a prerequisite to recovery, Staff states that while it is recognized that not all costs in

[173] *Id.* at 16; RUCO Reply Br. at 11.
[174] RUCO Reply Br. at 13, referencing Company Br. at 34 (which cited to cross-examination testimony of Pima's witness, Tr. at 208).
[175] RUCO Reply Br. at 11.
[176] RUCO Br. at 15, citing to *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 153, 294 P.2d 378, 383 (1956) and *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 533-34, 578 P.2d 612, 614-15 (App. 1978).
[177] RUCO Br. at 15-17.
[178] *Id.* at 15-16.
[179] Staff Br. at 8, 14.

the adjusted test year will precisely match the values derived from ratemaking adjustments to test year expenses, payment of income taxes was not an actual expense for Pima in the test year.[180] Staff states that while Pima has made much of the fact that Pima's owners as individuals, like many other investors, will pay income tax on earnings and distributions from the Company, these earnings and distributions are taxed at the owners' personal income tax rates, which is a result of Pima's internal decision to elect S corporation status, and that the individual income tax obligations of Pima's shareholders are not expenses that Pima itself must pay.[181]

Staff states that while Pima's witness Commissioner Spitzer testified that pass-through entities such as Pima are forced into a "Hobson's choice" in deciding the most advantageous corporate organization for tax purposes, he was unable to name one utility that sought to organize as a C corporation to avoid preclusion of an income tax allowance in rates.[182]

Staff argues that the Commission is not bound by FERC, but by the Arizona constitution and its statutes.[183] Staff asserts that in implementing its policy to provide an income tax expense allowance for pass-through entities, FERC was guided by policy reasons not present in Arizona, namely the need to raise capital investment to build needed infrastructure for oil and gas pipelines necessary to transverse the United States to provide service to millions of Americans.[184] Staff states that a number of natural gas and crude oil or petroleum products pipeline companies have been organized as, or have been reorganized to become, pass-through entities, and have become a significant source of capital for pipeline infrastructure investment.[185] Staff argues that the evidence in this record and the recent history of utility acquisitions in Arizona do not support Pima's argument that lack of an income tax allowance for pass-through entities presents an impediment to investment in Arizona infrastructure.[186] Staff notes that in the last five years, there has been significant acquisition activity in Arizona, including the 2010 acquisition of Chaparral City Water Company and that 2011 acquisition of Arizona-American Water Company, both by EPCOR USA, and the 2010

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[180] *Id.* at 8-9.
[181] *Id.* at 9.
[182] *Id.* at 9, citing to Tr. at 239 and 186-87.
[183] Staff Br. at 14.
[184] *Id.* at 9.
[185] *Id.* at 11, citing to Tr. at 244-246.
[186] Staff Reply Br. at 3.

acquisition of Perkins Mountain Water Company and Perkins Mountain Sewer in 2007.[187] Like RUCO, Staff also points to the history of Pima itself as evidence that lack of an income tax allowance for pass-through entities has not presented an impediment to investment in Arizona infrastructure.[188] Staff states that Pima did not need an income tax allowance to incent investment in the infrastructure necessary to provide utility service to its affiliated development.[189] Staff argues that if a regulatory incentive is needed for utility infrastructure investment in Arizona, the Commission has tools at its disposal that can be used to encourage such investment other than an allowance for an expense that the utility does not incur.[190]

Commenting on Pima's methodology for computing its proposed income tax allowance, Staff notes that Pima selected an overall tax rate of 27.49 percent with no submittal of documentation to support the rate.[191] Like RUCO, Staff is critical of Pima's lack of disclosure of actual taxes paid by its shareholders, stating that if the Commission is to entertain the idea of an income tax allowance, there should at least be a review of the tax returns of the entities and individuals who are shareholders.[192]

In response to Pima's argument that its provision of utility service gives rise to a tax liability, Staff states that it is undisputed that Pima, as an S corporation, incurs no tax liability and pays no income tax.[193] Staff argues that Pima's assertion that because income arises from the operation of the utility, income tax liability is a cost of service, conveniently ignores the fact that while a C corporation might actually incur a verifiable amount of income tax expense, the same cannot be said for a pass-through entity.[194]

Like RUCO, Staff notes that a substantial portion of the Company's requested rate relief, over 50 percent for its wastewater division and 30 percent for its water division, is attributable to its request for an income tax allowance.[195] Staff states that the Commission's role in setting rates is not

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[187] *Id.*
[188] *Id.*
[189] *Id.*
[190] *Id.* at 4.
[191] *Id.* at 13.
[192] *Id.*
[193] Staff Reply Br. at 4.
[194] *Id.*
[195] *Id.* at 5.

only to set rates so that a utility has an opportunity to earn a fair return, but also to set rates that protect utility consumers from overreaching.[196] Staff asserts that in this case, Pima's proposal amounts to overreaching, and recommends that no income tax expense allowance be granted.[197]

d. Discussion and Conclusion

Pima urges the Commission to make a policy determination to authorize Pima to recover an allowance for income tax expense through rates, using its witness Mr. Bourassa's calculation methodology.[198] As Staff points out, the Arizona Court of Appeals, in *Consolidated Water*, stated that it is within the discretion of this Commission to allow or disallow income tax expense.[199] This Commission has broad constitutional discretion, subject to the obligation to ascertain the fair value of the utility's property, to establish rates.[200] As the Company states, this Commission can include Pima's requested income tax allowance if we believe, based on substantial evidence, that doing so will result in just and reasonable rates.[201]

Pima contends that whether the taxes on the utility income of pass-through entities' shareholders are a utility cost of service isn't the issue.[202] Pima would prefer to frame the issue as whether "this particular cost of service" is recognized in rates.[203] Pima argues that although the income tax liability flows through to each utility shareholder, it is an expense that accrues just as depreciation, salary, maintenance or any other utility cost of service expense.[204] Plainly, there is an income tax liability on Pima's earned income. However, in order to set just and reasonable rates, we must determine whether that tax liability constitutes a cost of providing utility service to the ratepayers of Pima. That determination necessitates an examination of the entity to which the income tax liability accrues. Clearly in this case, due to Pima's election as an S corporation, it has chosen for the liability to accrue not to Pima, but to its shareholders. Pima has not claimed any legal

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[196] *Id.*
[197] *Id.*
[198] Co. Reply Br. at 18.
[199] *See* Staff Br. at 14, citing to *Consolidated Water Utils. v. Arizona Corp. Comm'n,* 178 Ariz. 478, 484, 875 P.2d 137, 143 (App. 1993).
[200] *See* Staff Reply Br. at 4-5, citing to *Scates v. Arizona Corp. Comm'n,* 118 Ariz. 531, 534, 578 P.2d 615 (App. 1978).
[201] Co. Reply Br. at 14.
[202] Co. Br. at 26.
[203] *Id.*
[204] *Id.*, citing to 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).

requirement to reimburse its shareholders for their personal income tax liability, and did not enter into evidence any "shareholder income tax payable" account balances. Pima, with its current S Corporation election, is not required to pay any income tax on its earnings. We decline to impose a requirement on its ratepayers to do so.

Pima would have the Commission believe that there is no material difference between allowing income tax expense in the revenue requirement for a C corporation that may not, due to other intervening income tax considerations, actually pay the authorized income tax expense to the taxing authority, and allowing income tax to be collected in rates for a pass-through entity such as Pima.[205] However, there is a legal distinction because a C corporation actually has an income tax obligation, while a pass-through entity does not. More importantly, however, Pima has failed to provide a convincing argument why this Commission should authorize rates sufficient to provide revenues to reimburse the personal income taxes accruing on the investment earnings of shareholders of a pass-through entity utility, while not similarly reimbursing the shareholders of a C corporation utility for the income taxes accruing on their utility earnings and dividends. In both cases, investor funds provide capital investment resulting in utility earnings. We see no fairness in setting rates in a way that would award tax-free earnings distributions to the investors of one utility, while leaving the investors of another utility to pay the income taxes accruing on the earnings distributions from their investment.

Pima argues that an income tax allowance is needed to encourage investment, and that the reasoning set forth by FERC in its income tax allowance policy is persuasive for granting Pima an income tax allowance. Pima's witness Mr. Spitzer testified that FERC's implementation of the policy to put an income tax allowance in rates for pass-through entities has provided a major source of interstate gas pipeline investment capital.[206] We do not have reason to disagree with Mr. Spitzer's

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[205] *See* Co. Br. at 29.

[206] Mr. Spitzer stated:

> [D]uring my tenure there at FERC we cited, under our authority to certificate natural gas pipelines . . . more miles of interstate natural gas pipelines than any time in the history of the country. And the prices, not only Henry hub, but the prices to customers at the city gates all across this country have dropped to save ratepayers of this country billions, if not over time trillions, of dollars. And I think FERC changing a policy statement and allowing an income tax allowance for pass-through entities was a major source of the investment of capital putting steel in the ground to benefit ratepayers.
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> Tr. at 245-46.

conclusion that the far-reaching national policy decision FERC implemented has spurred investment in interstate natural gas pipelines. However, the facts informing our determination in this case are very different from the facts underlying the FERC income tax allowance policy. While Arizona's water and wastewater utilities require infrastructure investment, they are not interstate natural gas pipeline companies. Pima has not alleged a necessity to extend its infrastructure so as to relieve congestion in delivering water to its customers, and has not demonstrated that building new infrastructure would result in a lowering of the costs to furnish water to its customers, or to treat their wastewater. Pima's argument that a failure to include an income tax allowance in its rates will impede its access to investment capital is not supported by the evidence in this case. As RUCO and Staff point out, Pima has been adequately capitalized as an S corporation without ratepayers paying its shareholders' income taxes. We find that the cost recovery and rate of return mechanisms currently in place sufficiently and fairly address Pima's water and wastewater system infrastructure needs.

The rates we approve in this Decision today, without a pass-through entity income tax allowance, fairly balance the need for just and reasonable compensation to Pima for its investment, and just and reasonable rates for Pima's ratepayers.

C. Operating Income Summary

	Water	Wastewater
Adjusted Test Year Revenues	$1,977,627	$3,096,775
Adjusted Test Year Operating Expenses	$1,695,931	$2,475,401
Adjusted Test Year Operating Income	$281,696	$621,374

V. COST OF CAPITAL

A. Capital Structure

The Company, RUCO and Staff are in agreement on a capital structure of 64.6 percent equity and 35.4 percent debt, which reflects debt financing approved by the Commission in Decision No. 73078 (April 5, 2012). We find the proposed capital structure reasonable and will adopt it.

B. Cost of Debt

The parties are in agreement on a cost of debt of 4.25 percent, based on the expected cost of debt on the financing approved in Decision No. 73078. For purposes of this rate case, we therefore adopt a cost of debt of 4.25 percent.

C. Cost of Equity

Pima is not a publicly traded company, and as such its cost of equity must be estimated. Witnesses for the Company, RUCO and Staff each calculated estimates for Pima's cost of equity using two financial models, the discounted cash flow ("DCF") model, and the capital asset pricing model ("CAPM"). The Company proposes a cost of equity of 10.5 percent,[207] RUCO recommends 9.4 percent,[208] and Staff recommends 9.4 percent.[209]

1. Pima

The Company proposes a cost of equity and weighted average cost of capital ("WACC") as follows:

	Percentage	Cost	Weighted Cost
Debt	35.36%	4.25%	1.50%
Common Equity	64.64%	10.50%	6.79%
Weighted Average Cost of Capital			8.29%

The Company's witness Mr. Bourassa used six publicly traded water utility companies[210] as proxies in his application of the DCF and CAPM finance models to reach his cost of equity recommendation. Mr. Bourassa performed a past and future growth DCF analysis, a future growth DCF analysis,[211] a historical market risk premium CAPM analysis, and a current market risk premium CAPM analysis.[212]

In his CAPM modeling, Mr. Bourassa used long-term forecasted U.S. Treasury securities rates as the measure of the risk-free return.[213] He used an average of actual first quarter 2012 long-term (30 year) U.S. Treasury securities rates and projected estimates of the long-term U.S. Treasury

[207] Company Final Schedules D-1 (water) and D-1 (wastewater).
[208] Direct Cost of Capital Testimony of RUCO witness William A. Rigsby (Exh. R-14) at 36-37.
[209] Surrebuttal Testimony of Staff witness John. A. Cassidy (Exh. S-9) at 2 and Schedule JAC-3.
[210] Direct Cost of Capital Testimony of Company witness Thomas J. Bourassa (Exh. A-7) at 17-21. The proxy companies Mr. Bourassa used are American States Water, Aqua America, California Water, Connecticut Water, Middlesex Water, and SJW Corp., all of which are followed by the *Value Line Investment Survey* ("*Value Line*").
[211] Rejoinder Cost of Capital Testimony of Company witness Thomas J. Bourassa (Exh. A-11) at Schedule D-4.8.
[212] *Id.* at Schedule D-4.12.
[213] Direct Cost of Capital Testimony of Company witness Thomas J. Bourassa (Exh. A-7) at 38.

securities rates for 2012 and 2013 from the April 12, 2012 *Blue Chip Financial Forecasts* and the February 24, 2012 *Value Line Quarterly* forecast as his risk-free rate in both his historical market risk premium CAPM analysis and his current market risk premium CAPM analysis.[214]

Mr. Bourassa's DCF estimates ranged from 9.7 percent to 11.3 percent, and his CAPM estimates ranged from 8.2 percent to 13.7 percent.[215] Mr. Bourassa took the average of the midpoint of his DCF and CAPM estimates, 10.7 percent,[216] and made a downward "Hamada" adjustment for financial risk of 30 basis points.[217] He then added his estimated "risk premium for small water utilities" of 80 basis points, to reach an indicated cost of equity of 11.2 percent.[218] Mr. Bourassa recommends a cost of equity for Pima of 10.5 percent.[219] Mr. Bourassa also used a methodology he called the Build-up Method, which produced a 14.46 percent average cost of equity estimate for Pima.[220] The Company asserts that the much higher results produced by use of the Build-up Method show that Mr. Bourassa's recommendation of 10.5 percent is conservative.[221] With the Company's 10.5 percent proposed cost of equity, the Company proposes a WACC of 8.29 percent.[222]

The Company is critical of the 9.4 percent cost of equity recommended by both RUCO and Staff. The Company asserts that RUCO's CAPM estimate of 4.58 percent is subjective and "absurdly" low, and states that RUCO rejected its own results in favor of its higher recommended cost of equity.[223] The Company argues that RUCO's and Staff's cost of equity recommendations, which are 110 basis points lower than the Company's, are not just and reasonable, because both RUCO and Staff failed to adjust their estimates upward after increasing the amount of debt in the

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[214] *Id.* at 38-39; Rejoinder Cost of Capital Testimony of Company witness Thomas J. Bourassa (Exh. A-11) at Schedules D-4.10, D-4.12.
[215] Rejoinder Cost of Capital Testimony of Company witness Thomas J. Bourassa (Exh. A-11) at Schedule D-4.1.
[216] *Id.*
[217] Direct Cost of Capital Testimony of Company witness Thomas J. Bourassa (Exh. A-7) at 41-42; Rejoinder Cost of Capital Testimony of Company witness Thomas J. Bourassa (Exh. A-11) at Schedules D-4.1, D-4.13, D-4.14, and D-4.15.
[218] Direct Cost of Capital Testimony of Company witness Thomas J. Bourassa (Exh. A-7) at 42-44; Rejoinder Cost of Capital Testimony of Company witness Thomas J. Bourassa (Exh. A-11) at Schedules at D-4.1 and D-4.16; Co. Br. at 40-41.
[219] Rejoinder Cost of Capital Testimony of Company witness Thomas J. Bourassa (Exh. A-11) at Schedules at D-4.1 and D-4.16.
[220] Direct Cost of Capital Testimony of Company witness Thomas J. Bourassa (Exh. A-7) at 27, 39-40, 46-47; Rebuttal Cost of Capital Testimony of Company witness Thomas J. Bourassa (Exh. A-9) at Tables 1-6.
[221] Co. Br. at 37.
[222] Rejoinder Cost of Capital Testimony of Company witness Thomas J. Bourassa (Exh. A-11) at 2 and Schedule D-1, page 1.
[223] Co. Br. at 42.

Company's capital structure.[224]

2. RUCO

RUCO recommends a cost of equity of 9.40 percent and a resulting WACC of 7.58 percent, as follows:[225]

	Percentage	Cost	Weighted Cost
Debt	35.36%	4.25%	1.50%
Common Equity	64.64%	9.40%	6.08%
Weighted Average Cost of Capital			7.58%

RUCO's witness Mr. Rigsby used a sample of five publicly traded water utilities and a sample of nine natural gas local distribution companies ("LDCs") in the analyses on which RUCO's recommendations are based.[226] Mr. Rigsby performed a DCF single-stage constant growth model estimate for both his water company sample and LDC sample. The average of the results of those two DCF estimates was 9.00 percent.[227] Mr. Rigsby made four CAPM estimates; one for the water company sample using the geometric mean, one for the LDC sample using the geometric mean, one for the water company sample using the arithmetic mean, and one for the LDC sample using the arithmetic mean.[228] In his CAPM estimates, Mr. Rigsby used a historical risk-free rate based on the geometric mean of the total returns of intermediate-term government bonds for the years 1926 to 2010.[229] Mr. Rigsby averaged his four CAPM estimate results, to reach an averaged result 4.47 percent.[230] He then averaged the CAPM average with his DCF average, to reach a cost of equity estimate of 6.74 percent.[231] Mr. Rigsby recommends a cost of equity for Pima of 9.4 percent, which is just below the high end of his range of estimates,[232] for a WACC of 7.58 percent.[233]

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[224] *Id.* at 42-43; Co. Reply Br. at 18-19.
[225] RUCO Final Schedule WAR-1, page 1.
[226] RUCO Final Schedules WAR-2-WAR-7. Mr. Rigsby's proxy water utilities are the same as those used by the Company and Staff, except that he did not use Connecticut Water.
[227] RUCO Final Schedule WAR-1, page 3.
[228] *Id.*
[229] Direct Cost of Capital Testimony of RUCO witness William A. Rigsby (Exh. R-14) at 34.
[230] RUCO Final Schedule WAR-1, page 3.
[231] *Id.*
[232] Direct Cost of Capital Testimony of RUCO witness William A. Rigsby (Exh. R-14) at 36-37; Surrebuttal Testimony of RUCO witness William A. Rigsby (Exh. R-10) at 15.
[233] RUCO Final Schedule WAR-1, page 1.

RUCO argues that the Company's cost of equity recommendation is too high given the current environment of low inflation and low interest rates.[234] RUCO contends that its cost of equity recommendation of 9.4 percent is supported by the fact that the Federal Reserve's current policy to keep interest rates low for an extended period of time has not changed recently,[235] and that the Company's recommendation for a 10.5 percent cost of equity is not justified by its arguments that Pima faces increased business risk due to its small size and the Arizona regulatory environment.[236] RUCO stated that its recommendation is only 10 basis points below the 9.5 percent *Value Line* projection for the water utility industry as a whole,[237] and asserts that its 9.4 percent cost of equity recommendation, which is more than double the Company's proposed cost of debt, is more than enough to compensate investors for any perceived business or financial risk.[238]

3. Staff

Staff recommends a cost of equity of 9.4 percent and a resulting WACC of 7.6 percent, as follows:[239]

	Percentage	**Cost**	**Weighted Cost**
Debt	35.4%	4.3%	1.5%
Common Equity	64.6%	9.4%	6.1%
Weighted Average Cost of Capital			7.6%

Staff's recommended 9.4 percent cost of equity is based on an average of the results of its witness John Cassidy's DCF and CAPM analyses.[240] Mr. Cassidy does not recommend a downward financial risk adjustment for Pima's cost of equity.[241] Mr. Cassidy's analyses were based on the same six water utility proxies used by Pima's witness.[242] For his DCF analysis, Mr. Cassidy used both a

[234] RUCO Br. at 26.
[235] RUCO Br. at 26 and RUCO Reply Br. at 19, citing to Surrebuttal Testimony of RUCO witness William A. Rigsby (Exh. R-10) at 14.
[236] RUCO Br. at 26.
[237] RUCO Br. at 26 and RUCO Reply Br. at 19, citing to Surrebuttal Testimony of RUCO witness William A. Rigsby (Exh. R-10) at 15.
[238] RUCO Reply Br. at 19, citing to Surrebuttal Testimony of RUCO witness William A. Rigsby (Exh. R-10) at 16.
[239] Surrebuttal Testimony of Staff witness John A. Cassidy (Exh. S-9) at Schedule JAC-1.
[240] *Id.* at 2 and Schedule JAC-3.
[241] Direct Testimony of Staff witness John. A. Cassidy (Exh. S-8) at 34.
[242] *Id* at 15.

constant growth and a multi-stage DCF model.[243] Mr. Cassidy's constant growth DCF model yielded an 8.2 percent cost of equity estimate, and his multi-stage DCF model yielded a 9.8 percent estimate.[244] Mr. Cassidy performed a historical market risk premium CAPM and a current market risk premium CAPM, using two separate parameters as surrogates for the estimations of the risk-free rates of interest.[245] For his historical market risk premium CAPM analysis, Staff's witness used an average of three intermediate-term (5, 7, and 10 year) U.S. Treasury securities spot rates, and for his current market risk premium CAPM analysis, he used a 30 year U.S. Treasury securities spot rate.[246]

Staff is critical of the Company's reliance solely on analysts' forecasts to estimate growth in its future growth DCF model.[247] Staff's witness testified that the appropriate growth rate to use in the DCF model is the dividend growth rate expected by investors, and that it is reasonable to assume that investors would consider both historical measures of past growth, as well as analysts' forecasts of future growth.[248] Staff's witness testified that an examination of the Company's DCF modeling schedules reveals that the analysis relied exclusively on analysts' forecasts.[249] Staff states that its DCF analysis gives equal weight to historical and analysts' forecasts.[250] Staff recommends against exclusive reliance on analysts' forecasts, because they can be overly optimistic.[251]

Staff also recommends that any financial risk adjustment or small size risk premium be rejected.[252] Staff's witness testified that all companies have firm-specific risk, and the existence of unique risks for a company does not lead to the conclusion that one company's total risk is greater than that of other companies.[253] Staff states that firm-specific risk can be eliminated through diversification.[254]

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[243] *Id* at 16.
[244] Surrebuttal Testimony of Staff witness John. A. Cassidy (Exh. S-9) at Schedule JAC-3.
[245] Direct Testimony of Staff witness John. A. Cassidy (Exh. S-8) at 29; Surrebuttal Testimony of Staff witness John. A. Cassidy (Exh. S-9) at Schedule JAC-3.
[246] *Id.*
[247] Staff Br. at 16.
[248] Direct Testimony of Staff witness John. A. Cassidy (Exh. S-8) at 37.
[249] *Id.* (referring to Mr. Bourassa's Schedule D-4.6).
[250] Staff Br. at 16, citing to Direct Testimony of Staff witness John. A. Cassidy (Exh. S-8) at 36.
[251] *Id.*
[252] Staff Br. at 16.
[253] *Id.*, citing to Direct Testimony of Staff witness John. A. Cassidy (Exh. S-8) at 44.
[254] Staff Br. at 16.

4. Discussion and Conclusion

Taking into consideration all of the cost of equity analyses performed by the witnesses, we find that a cost of equity of 9.49 percent is reasonable, will provide the Company with a reasonable and appropriate return on its investment, and will result in just and reasonable rates.

D. Cost of Capital Summary

	Percentage	Cost	Weighted Cost
Debt	35.36%	4.25%	1.50%
Common Equity	64.64%	9.49%	6.13%
Weighted Average Cost of Capital			**7.63%**

VI. REVENUE REQUIREMENT

Based on the discussion herein, revenue increases for Pima's water and wastewater divisions are authorized as follows:

A. Water

Based on our findings herein, we determine that gross revenue for Pima's water division should increase by $419,989, or 21.24 percent.

Fair Value Rate Base	$9,122,677
Adjusted Operating Income	281,696
Required Fair Value Rate of Return	7.63%
Required Operating Income	$ 696,060
Operating Income Deficiency	414,365
Gross Revenue Conversion Factor	1.01357
Gross Revenue Increase	$ 419,989

B. Wastewater

Based on our findings herein, we determine that gross revenue for Pima's wastewater division should increase by $135,438, or 4.37 percent.

Fair Value Rate Base	$9,895,103
Adjusted Operating Income	621,374
Required Fair Value Rate of Return	7.63%
Required Operating Income	$ 754,996
Operating Income Deficiency	133,622
Gross Revenue Conversion Factor	1.01359
Gross Revenue Increase	$ 135,438

VII. RATE DESIGN

A. Water

Pima's current residential rate design is a two-tier rate design that includes 1,000 gallons in the minimum monthly charge. Pima, RUCO and Staff all recommend an inverted three tier residential rate design with no gallonage included in the minimum monthly charge, a first tier breakover point of 4,000 gallons, and a second tier breakover point of 10,000 gallons.[255] The parties' rate designs differ in the percentage of revenue recovery in their monthly minimum charges. The Company states that it prefers Staff's rate design to RUCO's, because Staff's monthly minimum charge is designed to recover a greater percentage of the revenue requirement.[256]

The parties' rate designs all add a third tier commodity rate to the current rate design, and all three differ in the level of commodity rate charges for the first tier of usage. The Company's proposed first tier commodity rate is set at the same level as the current first tier rate. RUCO and Staff's rate designs both reduce their first tier commodity rates, with Staff's reduced to a greater extent. The Company argues that Staff's rate design, with its lower first tier commodity rate, sends a mixed conservation message that water is less expensive today.[257] The Company states that it believes customers should be urged to conserve water at all usage levels.[258]

The rate design proposed by Staff includes the most affordable rates for the first 4,000 gallons of water usage, with an increase for usage above 4,000 gallons a month, and a greater increase for usage over 10,000 gallons. While we understand the Company's concern that rate design should send the proper price signals to customers, we disagree with the Company's argument that Staff's rate design sends a signal that water is less expensive today. Staff's rate design increases rates at all usage levels.[259] We find the lower first tier commodity rate in Staff's rate design to be appropriate, because it makes a minimal amount of water usage more affordable for low income customers. We find Staff's recommended rate design to be reasonable and will adopt it.

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[255] Company Final Schedule H-3 (water); RUCO Surrebuttal Testimony of RUCO witness Robert B. Mease (Exh. R-4) at Surrebuttal Schedule RBM RD-2; Staff Final Schedule CSB-19 (water).
[256] Co. Br. at 44.
[257] *Id.*
[258] *Id.* at 43-44.
[259] Staff Final Schedule CSB-20 (wastewater).

B. Wastewater

There was no dispute regarding wastewater rate design, as all parties propose a flat monthly charge for each meter size. We find this rate design reasonable under the facts of this case.

VIII. BEST MANAGEMENT PRACTICES ("BMP") TARIFFS

Staff recommends that the Company be required to file at least seven BMPs in the form of tariffs that substantially conform to the templates available on the Commission's website. Staff recommends that the Company submit its approved ADWR BMPs and its public education program as part of the seven.

Pima states that it does not believe additional water conservation requirements are necessary, as Pima is in compliance with the Arizona Department of Water Resources ("ADWR") requirements.[260] Pima states that it has a fully functioning water conservation program that includes five BMPs and a customer education program as mandated by ADWR,[261] and that Pima is required to file reports with ADWR on all its water conservation efforts.[262] Pima argues that it does not want to be subject to water conservation regulations from more than one agency, and that there is no evidence that additional regulation is necessary.[263] Pima further argues that the fact that other utilities have been ordered to submit BMP tariffs does not justify or provide a rational basis for duplicative regulation.[264]

Pima is located in the Phoenix Active Management Area ("AMA"). Due to the fact that Pima's service territory is located within an AMA, we find that it is in the public interest to require Pima to file at least seven BMP tariffs with the Commission as recommended by Staff.

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Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. On August 29, 2011, Pima filed with the Arizona Corporation Commission

[260] Co. Br. at 46.
[261] Direct Testimony of Company witness Ray L. Jones (Exh. A-1) at 5; Tr. at 27.
[262] Tr. at 28.
[263] Co. Br. at 46; Co. Reply Br. at 19; Tr. at 28-29.
[264] Co. Reply Br. at 19.

applications for rate increases in both its water and wastewater divisions, based on a test year ending December 31, 2010.

2. On September 29, 2011, Staff filed a Letter of Sufficiency in each of the dockets, notifying the Company that the applications were deemed sufficient pursuant to A.A.C. R14-2-103, and classifying Pima as a Class B utility.

3. Also on September 29, 2011, Pima filed Motions to Consolidate in the dockets.

4. On September 30, 2011, a Rate Case Procedural Order was issued consolidating the applications for purposes of hearing, setting a hearing on the consolidated applications, and setting associated procedural deadlines.

5. On December 9, 2011, Pima filed a Notice of Filing Certification of Publication and Proof of Mailing, indicating that the required public notice was accomplished.

6. A total of 291 written public comments were filed in response to the applications.

7. On December 20, 2011, RUCO filed an Application to Intervene, which was granted by Procedural Order issued January 9, 2012.

8. No other intervention requests were filed.

9. On March 8, 2012, a copy of an email response by Commissioner Burns' office to customer comment emails was docketed.

10. On March 27, 2012, RUCO filed the direct testimonies of its witnesses William A. Rigsby, Timothy J. Coley, and Robert B. Mease.

11. Also on March 27, 2012, Staff filed a Motion for Extension of Time requested that the procedural schedule established by the September 30, 2011 Rate Case Procedural Order be modified. The Motion indicated that Staff contacted counsel for the parties, and all the parties were agreeable to the requested time extensions.

12. By Procedural Order issued March 28, 2012, Staff's request was granted.

13. On March 29, 2012, RUCO filed a Notice of Errata.

14. On April 2, 2012, Staff filed the direct testimonies of its witnesses Crystal S. Brown, John A. Cassidy, and Marlin Scott, Jr.

15. On April 3, 2012, RUCO filed the corrected rate design schedules to the direct

testimony of Robert B. Mease.

16. On April 27, 2012, Pima filed the rebuttal testimonies of its witnesses Steven Soriano, Ray L. Jones, Marc L. Spitzer, and Thomas J. Bourassa.

17. On April 30, 2012, Commissioner Bob Stump and Commissioner Brenda Burns filed a letter requesting that the Commissioners approve the scheduling of a public comment hearing.

18. On May 16, 2012, the Company, RUCO and Staff jointly filed a Stipulated Request to Modify Procedural Schedule.

19. On May 17, 2012, a Procedural Order was issued extending the deadline for prefiling rejoinder testimony from May 24, 2012, at noon, to May 25, 2012. The Procedural Order also directed that the hearing would convene for public comment on May 29, 2012, as previously scheduled and publicly noticed, and that the evidentiary portion of the hearing would commence on May 30, 2012.

20. On May 18, 2012, RUCO filed the surrebuttal testimonies of its witnesses William A. Rigsby, Timothy J. Coley, and Robert B. Mease.

21. Also on May 18, 2012, Staff filed the surrebuttal testimonies of its witnesses Crystal S. Brown, John A. Cassidy, and Marlin Scott, Jr.

22. On May 23, 2012, RUCO filed a Notice of Errata.

23. The prehearing conference convened as scheduled on May 24, 2012.

24. On May 25, 2012, Pima filed the rejoinder testimonies of its witnesses Ray L. Jones, Marc L. Spitzer, and Thomas J. Bourassa. On that date, Pima also filed the testimony summaries of its witnesses Steven Soriano, Ray L. Jones, and Thomas J. Bourassa.

25. On May 29, 2012, Pima filed the testimony summary of its witness Marc L. Spitzer.

26. Also on May 29, 2012, RUCO filed testimony summaries of its witnesses.

27. On May 30, 2012, Staff filed testimony summaries of its witnesses.

28. The hearing convened on May 29, 2012, for the purpose of taking public comment.

29. The evidentiary hearing commenced as scheduled before a duly authorized Administrative Law Judge of the Commission on May 30, 2012, and concluded on June 1, 2012.

30. Because a number of public comments were filed in opposition to the proposed rate

increases, the Commission scheduled a local public comment session to be held in Sun Lakes on July 10, 2012.

31. A Procedural Order was issued on June 1, 2012, directing the Company to provide public notice of the July 10, 2012, local public comment session.

32. On June 20, 2012, Pima filed a Notice of Filing Late Filed Exhibits.

33. On June 26, 2012, Pima, RUCO, and Staff filed their respective Final Schedules.

34. On June 28, 2012, RUCO filed a Notice of Filing Revised Schedules.

35. On July 3, 2012, Pima, RUCO, and Staff filed their respective Initial Post-Hearing Briefs.

36. A local public comment session was held as scheduled by the Commissioners in Sun Lakes, Chandler, Arizona on July 10, 2012.

37. On July 27, 2012, Pima, RUCO, and Staff filed their respective Reply Post-Hearing Briefs.

38. As discussed herein, an appropriate and reasonable capital structure for the Company is 35.36 percent debt and 64.64 percent equity. The cost of debt is 4.25 percent, and an appropriate and reasonable cost of equity is 9.49 percent.

39. Pima's water division experienced adjusted test year revenues of $1,977,627.

40. For its water division, Pima requested rates that would result in total revenues of $2,717,184, a revenue increase of $739,557, or 37.40 percent. Pima's proposal would result in an approximate $3.28 increase for the average usage (6,395 gallons per month) 5/8 x 3/4 inch meter residential customer, from $10.66 per month to $13.94 per month, or approximately 30.77 percent.

41. RUCO recommended rates for the water division that would yield total revenues of $2,419,407, an increase of $441,780, or 22.34 percent. RUCO's recommendation would result in an approximate $1.33 increase for the average usage (6,395 gallons per month) 5/8 x 3/4 inch meter residential customer, from $10.66 per month to $11.99 per month, or approximately 12.48 percent.

42. Staff recommended total revenues for the water division of $2,434,827, an increase of $457,200, or 23.12 percent. Staff's recommendation would result in an approximate $1.54 increase for the average usage (6,395 gallons per month) 5/8 x 3/4 inch meter residential customer, from

$10.66 per month to $12.20 per month, or approximately 14.45 percent.

43. Pima's wastewater division experienced adjusted test year revenues of $3,096,775.

44. For its wastewater division, Pima requested rates that would result in total revenues of $3,522,034, a revenue increase of $425,259, or 13.73 percent. Pima's proposal would result in an approximate $3.36 increase for 5/8 x 3/4 inch meter residential customers, from $22.73 per month to $26.09 per month, or approximately 14.78 percent.

45. RUCO recommended rates for the wastewater division that would yield total revenues of $3,198,757, an increase of $101,982, or 3.29 percent. RUCO's recommendation would result in an approximate $0.73 increase for 5/8 x 3/4 inch meter residential customers, from $22.73 per month to $23.46 per month, or approximately 3.21 percent.

46. Staff recommended total revenues for the wastewater division of $3,225,350, an increase of $128,575, or 4.15 percent. Staff's recommendation would result in an approximate $1.18 increase for 5/8 x 3/4 inch meter residential customers, from $22.73 per month to $23.91 per month, or approximately 5.19 percent.

47. As discussed herein, the FVRB for the Company's water division is determined to be $9,122,677, and for the wastewater division, the FVRB for the Company's wastewater division is determined to be $9,895,103.

48. A fair value rate of return on FVRB of 7.63 percent is reasonable and appropriate.

49. The revenue increase requested by the Company for the water and wastewater divisions would produce excessive returns on FVRB.

50. The revenue requirement authorized herein for Pima's water division is $2,397,616, which is an increase of $419,989, or 21.24 percent, over adjusted test year revenues of $1,977,627. The rates approved herein will result in an approximate $1.30 increase for the average usage (6,395 gallons per month) 5/8 x 3/4 inch meter residential customer, from $10.66 per month to $11.96 per month, or approximately 12.20 percent.

51. The revenue requirement authorized herein for Pima's wastewater division is $3,232,213, which is an increase of $135,438, or 4.37 percent, over adjusted test year revenues of $3,096,775. The rates approved herein will result in an approximate $1.24 increase for 5/8 x 3/4 inch

meter residential customers, from $22.73 per month to $23.97 per month, or approximately 5.46 percent.

52. The rate designs proposed by Staff are reasonable and should be adopted in this proceeding.

53. The Maricopa County Environmental Services Department ("MCESD") reported that Pima's drinking water system is currently in compliance with MCESD regulations.

54. ADEQ reported that Pima's wastewater system has no deficiencies and is in compliance with ADEQ regulations.

55. Pima's service territory is located within the Phoenix AMA. Pima is in compliance with ADWR reporting and conservation requirements.

56. The Company has an approved curtailment plan tariff and an updated backflow prevention tariff on file.

57. The Company should be required to use, on a going-forward basis, the depreciation rates delineated on Exhibit A, attached hereto and incorporated herein.

58. The Company should be required to file at least seven BMPs, which may include Pima's ADWR-approved BMPs and its public education program, in the form of tariffs that substantially conform to the BMP templates available on the Commission's website.

59. The Company should be authorized to implement a surcharge of $0.33 per customer for the water division, and a surcharge of $0.33 per customer for the wastewater division, with each surcharge remaining in place for either: (1) a period of 60 months, or (2) until the division has collected $200,000 in rate case expense recovery, or (3) until new rates go into effect for the division as a result of a rate case subsequent to this one, whichever occurs sooner.

CONCLUSIONS OF LAW

1. Pima is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-250 and 40-251.

2. The Commission has jurisdiction over Pima and the subject matter of the applications.

3. Notice of the applications was provided in the manner prescribed by law.

4. The rates and charges authorized herein are just and reasonable and should be

approved.

5. It is reasonable and in the public interest to authorize a surcharge of $0.33 per customer for the water division, and a surcharge of $0.33 per customer for the wastewater division, with each surcharge remaining in place for either: (1) a period of 60 months, or (2) until the division has collected $200,000 in rate case expense recovery, or (3) until new rates go into effect for the division as a result of a rate case subsequent to this one, whichever occurs sooner.

6. It is reasonable and in the public interest to require Pima to use Staff's typical and customary depreciation rates as delineated in Exhibit A.

7. It is reasonable and in the public interest to require Pima to file at least seven BMPs, which may include Pima's ADWR-approved BMPs and its public education program, in the form of tariffs that substantially conform to the BMP templates available on the Commission's website.

ORDER

IT IS THEREFORE ORDERED that Pima Utility Company shall file with Docket Control, as a compliance item in this docket, by October 31, 2012, revised rate schedules setting forth the following rates and charges:

WATER DIVISION

MONTHLY MINIMUM CHARGE (All Classes):

5/8" x 3/4" Meter	$ 7.00
3/4" Meter	10.50
1" Meter	20.00
1-1/2" Meter	35.00
2" Meter	56.00
3" Meter	130.00
4" Meter	175.00
6" Meter	350.00

COMMODITY CHARGE – Per 1,000 Gallons:

5/8 x 3/4-Inch Meter (Residential)

First 4,000 gallons	$0.67
4,001 gallons to 10,000 gallons	0.95
Over 10,000 gallons	1.36

5/8 x 3/4-Inch Meter (Commercial)

First 10,000 gallons	$0.95
Over 10,000 gallons	1.36

3/4-Inch Meter (Residential)	
First 4,000 gallons	$0.67
4,001 gallons to 10,000 gallons	0.95
Over 30,000 gallons	1.36
3/4-Inch Meter (Commercial)	
First 10,000 gallons	$0.95
Over 10,000 gallons	1.36
1-Inch Meter – Residential/Commercial	
First 30,000 gallons	$0.95
Over 30,000 gallons	1.36
1 1/2-Inch Meter – Residential/Commercial	
First 65,000 gallons	$0.95
Over 65,000 gallons	1.36
2-Inch Meter – Residential/Commercial	
First 110,000 gallons	$0.95
Over 110,000 gallons	1.36
3-Inch Meter – Residential/Commercial	
First 275,000 gallons	$0.95
Over 275,000 gallons	1.36
4-Inch Meter – Residential/Commercial	
First 375,000 gallons	$0.95
Over 375,000 gallons	1.36
6-Inch Meter – Residential/Commercial	
First 800,000 gallons	$0.95
Over 800,000 gallons	1.36
Irrigation (all meter sizes)	$0.51
Construction/Standpipe	$1.36

SERVICE LINE AND METER INSTALLATION CHARGES:

	Service Line	Meter Installation	Total
5/8" x ¾ " Meter	$ 385.00	$ 135.00	$ 520.00
3/4 " Meter	415.00	205.00	620.00
1" Meter	465.00	265.00	730.00
1-1/2" Meter	520.00	475.00	995.00
2" Turbine Meter	800.00	995.00	1,795.00
2" Compound Meter	800.00	1,840.00	2,640.00
3" Turbine Meter	1,015.00	1,620.00	2,635.00
3" Compound Meter	1,135.00	2,495.00	3,630.00
4" Turbine Meter	1,430.00	2,570.00	4,000.00

4" Compound Meter	1,610.00	3,545.00	5,155.00
6" Turbine Meter	2,150.00	4,925.00	7,075.00
6" Compound Meter	2,270.00	6,820.00	9,090.00

MISCELLANEOUS SERVICE CHARGES:

Establishment	$25.00
Re-Establishment (Within 12 Months)	*
Reconnection (Delinquent)	$25.00
Meter Test (If correct)	20.00
Meter Re-read (If correct)	25.00
Deposit	**
Deposit Interest	**
NSF Check	$15.00
Deferred Payment, per month	1.50%
Late Payment Fee (Per month)	1.50%
After hours service charge (at customer's request)	$50.00

* Number of months off the system times the monthly minimum.

** Per A.A.C. R14-2-403.B

WASTEWATER DIVISION

MONTHLY CHARGE (All Classes):

5/8" x 3/4" Meter	$ 23.97
3/4" Meter	37.26
1" Meter	62.56
1-1/2" Meter	123.72
2" Meter	197.54
3" Meter	383.50
4" Meter	599.22
6" Meter	1,198.44

EFFLUENT SALES:

Monthly Minimum	$180.00
Charge Per 1,000 gallons	0.46

RECOVERED EFFLUENT SALES:

Monthly Minimum	$180.00
Charge Per 1,000 gallons	0.46

MISCELLANEOUS SERVICE CHARGES:

Establishment Fee	$ 25.00
Reestablishment (within 12 months)	*
Deferred payment (per month)	1.50%
Deposit	**
Deposit Interest	**
NSF Check	$ 15.00

Late payment fee (per month)***	1.50%
Reconnection (Delinquent)	$ 25.00
After Hours Service Charge (at the customer's request)	$ 50.00

* Number of months off the system times the applicable sewer charges.

** Per A.A.C. R14-2-603.B.7 and 603.B.3

*** Late payment charge based upon balance owing at the end of the billing cycle which is added to the next bill.

IT IS FURTHER ORDERED that Pima Utility Company is hereby authorized to implement a surcharge of $0.33 per customer for the water division, and a surcharge of $0.33 per customer for the wastewater division. Each surcharge shall remain in place for either: (1) a period of 60 months, or (2) until the division has collected $200,000 in rate case expense recovery, or (3) until new rates go into effect for the division as a result of a rate case subsequent to this one, whichever occurs sooner.

IT IS FURTHER ORDERED that the above rates and charges shall be effective for all service provided on and after November 1, 2012.

IT IS FURTHER ORDERED that Pima Utility Company shall notify its customers of the rates and charges authorized herein, including the rate case expense recovery surcharge, and their effective date, in a form acceptable to the Commission's Utilities Division Staff, by means of an insert in its next regularly scheduled billing.

IT IS FURTHER ORDERED that, in addition to collection of its regular rates and charges, Pima Utility Company shall collect from its customers a proportionate share of any privilege, sales or use tax per A.A.C. R14-2-409(D).

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IT IS FURTHER ORDERED that Pima Utility Company shall file with Docket Control, within 30 days, as a compliance item in this docket, at least seven BMPs in the form of tariffs that substantially conform to the BMP templates available on the Commission's website. The seven BMPs may include Pima's ADWR-approved BMPs and its public education program.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN		COMMISSIONER
COMMISSIONER	COMMISSIONER	COMMISSIONER

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this _______________day of ____________________ 2012.

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ERNEST G. JOHNSON
EXCUTIVE DIRECTOR

DISSENT ____________________________

DISSENT ____________________________

SERVICE LIST FOR: PIMA UTILITY COMPANY

DOCKET NOS.: W-02199A-11-0329 and SW-02199A-11-0330

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EXHIBIT A

Water Depreciation Rates

NARUC Acct. No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
304	Structures & Improvements	30	3.33
305	Collecting & Impounding Reservoirs	40	2.50
306	Lake, River, Canal Intakes	40	2.50
307	Wells & Springs	30	3.33
308	Infiltration Galleries	15	6.67
309	Raw Water Supply Mains	50	2.00
310	Power Generation Equipment	20	5.00
311	Pumping Equipment	8	12.5
320	Water Treatment Equipment		
320.1	Water Treatment Plants	30	3.33
320.2	Solution Chemical Feeders	5	20.0
330	Distribution Reservoirs & Standpipes		
330.1	Storage Tanks	45	2.22
330.2	Pressure Tanks	20	5.00
331	Transmission & Distribution Mains	50	2.00
333	Services	30	3.33
334	Meters	12	8.33
335	Hydrants	50	2.00
336	Backflow Prevention Devices	15	6.67
339	Other Plant & Misc Equipment	15	6.67
340	Office Furniture & Equipment	15	6.67
340.1	Computers & Software	5	20.00
341	Transportation Equipment	5	20.00
342	Stores Equipment	25	4.00
343	Tools, Shop & Garage Equipment	20	5.00
344	Laboratory Equipment	10	10.00
345	Power Operated Equipment	20	5.00
346	Communication Equipment	10	10.00
347	Miscellaneous Equipment	10	10.00
348	Other Tangible Plant	---	---

NOTE: Acct. 348 – Other Tangible Plant may vary from 5% to 50%. The depreciation rate would be set in accordance with the specific capital items in this account.

Wastewater Depreciation Rates

NARUC Acct. No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
354	Structures & Improvements	30	3.33
355	Power Generation Equipment	20	5.00
360	Collection Sewers – Force	50	2.0
361	Collection Sewers- Gravity	50	2.0
362	Special Collecting Structures	50	2.0
363	Services to Customers	50	2.0
364	Flow Measuring Devices	10	10.00
365	Flow Measuring Installations	10	10.00
366	Reuse Services	50	2.00
367	Reuse Meters & Meter Installations	12	8.33
370	Receiving Wells	30	3.33
371	Pumping Equipment	8	12.50
374	Reuse Distribution Reservoirs	40	2.50
375	Reuse Transmission & Distribution System	40	2.50
380	Treatment & Disposal Equipment	20	5.0
381	Plant Sewers	20	5.0
382	Outfall Sewer Lines	30	3.33
389	Other Plant & Miscellaneous Equipment	15	6.67
390	Office Furniture & Equipment	15	6.67
390.1	Computers & Software	5	20.0
391	Transportation Equipment	5	20.0
392	Stores Equipment	25	4.0
393	Tools, Shop & Garage Equipment	20	5.0
394	Laboratory Equipment	10	10.0
395	Power Operated Equipment	20	5.0
396	Communication Equipment	10	10.0
397	Miscellaneous Equipment	10	10.0
398	Other Tangible Plant	----	----

NOTE: Acct. 398 – Other Tangible Plant may vary from 5 percent to 50 percent. The depreciation rate would be set in accordance with the specific capital items in this account.