

OPEN MEETING ITEM

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BOB BURNS
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ARIZONA CORPORATION COMMISSION

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JUL - 2 2013

DATE: JULY 2, 2013
DOCKET NO.: WS-02676A-12-0196

DOCKETED BY
MR

TO ALL PARTIES:

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

RIO RICO UTILITIES, INC.
(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:

JULY 11, 2013

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:

JULY 17, 2013 AND JULY 18, 2013

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.

Jodi A. Jerich
JODI JERICH
EXECUTIVE DIRECTOR

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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 BOB STUMP - Chairman
4 GARY PIERCE
5 BRENDA BURNS
6 BOB BURNS
7 SUSAN BITTER SMITH

8 IN THE MATTER OF THE APPLICATION OF
9 RIO RICO UTILITIES, INC., AN ARIZONA
10 CORPORATION, FOR A DETERMINATION OF
11 THE FAIR VALUE OF ITS UTILITY PLANTS
12 AND PROPERTY AND FOR INCREASES IN ITS
13 WATER AND WASTEWATER RATES AND
14 CHARGES FOR UTILITY SERVICE BASED
15 THEREON.

DOCKET NO. WS-02676A-12-0196

DECISION NO. _____

OPINION AND ORDER

11 DATE OF HEARING:

March 27-29, 2013

12 PLACE OF HEARING:

Tucson, Arizona

13 ADMINISTRATIVE LAW JUDGE:

Jane L. Rodda

14 APPEARANCES:

Jay Shapiro, FENNEMORE CRAIG, PC,
for Rio Rico Utilities, Inc.;

Michelle Wood, Staff Attorney,
Residential Utility Consumer Office;

Charlene Laplante, Office of the Santa
Cruz County Attorney, for Santa Cruz
County;

Roger C. Decker, UDALL SHUMWAY,
PLC, for Santa Cruz Valley School
District No. 35; and

Bridget A. Humphrey, Scott Hesla,
Matthew Laudone, Staff Attorneys, Legal
Division for the Arizona Corporation
Commission Utilities Division.

23 **BY THE COMMISSION:**

24 **I. Background and Procedural History**

25 Rio Rico Utilities, Inc. ("RRUI" or the "Company") provides water and wastewater service to
26 an area of Santa Cruz County, Arizona. In the test year ended February 29, 2012, the Company
27 provided water-only service to approximately 6,751 connections, and combined water and
28

1 wastewater service to 2,207 connections. RRUI is a subsidiary of Liberty Utilities Co. ("Liberty
 2 Utilities"), which in turn is a subsidiary of Algonquin Power & Utilities Corporation ("APUC"), a
 3 publicly-traded corporation on the Toronto Stock Exchange.¹ Liberty Utilities is APUC's regulated
 4 utility business division and provides water, wastewater and electric utility services to more than
 5 120,000 customers through 22 utility systems.² RRUI's current rates were set in Decision No. 72059
 6 (January 6, 2011).

7 RRUI's service territory is very hilly, causing the water system to be divided into seven
 8 pressure zones and dotted with about 26 small pressure tanks and booster stations in addition to the
 9 major pumping and storage facilities.³ The Company has six wells and 2,130,000 gallons of storage
 10 capacity. RRUI has two separate wastewater systems. The larger wastewater system, which serves
 11 approximately 2,060 customers, consists of five large pumping stations and enters the City of
 12 Nogales sewage collection system where it eventually reaches the Nogales International Wastewater
 13 Treatment facility. RRUI contracts with the City of Nogales for capacity. RRUI also operates a much
 14 smaller wastewater system which serves the "Villas Unit 12" subdivision, consisting of a single
 15 pumping station and an aerobic stabilization pond. This facility serves about 140 customers.

16 On May 31, 2012, RRUI filed an application with the Arizona Corporation Commission
 17 ("Commission") for a rate increase ("Rate Application").

18 On June 28, 2012, RRUI filed an Amendment to its Application.

19 On July 2, 2012, the Commission's Utilities Division ("Staff") notified the Company that its
 20 Rate Application was sufficient under the guidelines outlined in the Arizona Administrative Code
 21 ("A.A.C.") R14-2-103, and classified the utility as Class B.

22 On July 5, 2012, Staff filed a Proposed Schedule and Request for Procedural Order.

23 On July 6, 2012, the Residential Utility Consumer Office ("RUCO") filed an Application to
 24 Intervene.

25

26 ¹ Liberty Utilities also owns Liberty Energy Utilities, Co., which holds interests in a number of energy companies.

27 ² Ex A-7 Sorensen Dir at 2. In addition, after filing its Rate Application, Liberty Utilities acquired two additional utilities,
 an electric distribution utility in New Hampshire and a natural gas distribution utility in Missouri, Illinois and Iowa,
 which together serve approximately 213,000 customers. See Tr. at 331 (Sorensen).

28 ³ Ex S-5 Liu Dir at Engineering Report.

1 By Procedural Order dated July 13, 2012, RUCO was granted intervention, the hearing in this
2 matter was set for March 26, 2013, and other procedural deadlines were established, including dates
3 to file written testimony and for intervention.⁴

4 On August 13, 2012, RRUI filed a Request to Modify Procedural Schedule by moving the
5 start of the hearing one day later to March 27, 2013. By Procedural Order dated August 17, 2012, the
6 request was granted.

7 On October 5, 2012, RRUI filed an Affidavit of Certification of Mailing and Publication
8 indicating that notice of the hearing was published in the *Nogales International* on September 21,
9 2012, and mailed to customers on September 7, 2012, September 12, 2012, and September 24, 2012.

10 On December 13, 2012, Santa Cruz County ("County") filed a Request to Intervene, which
11 was granted on December 28, 2012.

12 On December 31, 2012, Staff and RUCO filed direct testimony related to rate base and
13 revenue requirement.

14 On January 7, 2013, Staff and RUCO filed direct testimony related to cost of capital and rate
15 design.

16 On January 25, 2013, the Santa Cruz County School District No. 35 ("School District"), a
17 customer of RRUI, filed a Motion to Intervene.⁵

18 On January 28, 2013, RRUI filed its rebuttal testimony.

19 On January 30, 2013, RRUI filed a Response to School District's request to intervene, stating
20 that it did not object to the late request for intervention as long as the School District complied with
21 the existing procedural schedule.

22 On February 4, 2013, School District was granted intervention, however, the Notification of
23 Intervention recognized that the deadline to intervene was December 15, 2012, and specifically
24 provided that School District must accept established deadlines for testimony and hearing, and would
25 only be allowed to represent its own interests and not those of students, faculty or employees.

26 On February 19, 2013, RUCO and Staff filed their surrebuttal testimony.⁶

27 _____
28 ⁴ By Procedural Order dated July 19, 2012, the date for filing rejoinder testimony was corrected.

⁵ The July 13, 2012, Procedural Order set December 15, 2012, as the deadline to request intervention.

1 On February 26, 2013, RRUI filed an Unopposed Request for Extension of Time to file
2 rejoinder testimony. The Request was granted by Procedural Order dated February 28, 2013.

3 On March 1, 2013, RRUI filed a Request for Change to Pre-hearing Conference, to have the
4 scheduled Pre-hearing Conference conducted telephonically. RRUI also filed a Motion to Bifurcate,
5 requesting that the rate case be conducted in two phases, with the first phase addressing issues related
6 to fair value and charges, and the second phase addressing the Company's request for a Distribution
7 System Improvement Charge ("DSIC") for the Water Division and a Collection System Improvement
8 Charge for the Wastewater Division. RRUI proposed that Phase 1 commence as scheduled on March
9 27, 2013, and that Phase 2 commence 20 days after a final decision by the Commission in the second
10 phase of Arizona Water Company's ("AWC") pending rate case (Docket No. W-01445A-11-0310) in
11 which a DSIC proposal was being considered.

12 On March 7, 2013, RUCO filed a Response to the Motion to Bifurcate. RUCO did not oppose
13 bifurcation as long as: 1) all parties were allowed to supplement the record on how the cost of equity
14 might be affected by the adoption of a DSIC mechanism; and 2) all pre-filed testimony related to the
15 DSIC or the Sustainable Water Loss Improvement Program ("SWIP")⁷ was included in the record.

16 On March 8, 2013, School District and County (collectively "Intervenors") filed a Response
17 to RRUI's Motion to Bifurcate. Intervenors opposed bifurcation on the grounds that the DSIC is not a
18 stand-alone rate-making issue and its approval would affect the Company's financial risk and cost of
19 equity. Intevenors also alleged that they were prejudiced in this proceeding by RRUI's shifting
20 positions on the issue of a DSIC-like mechanism, having first proposed a SWIP, then a Systems
21 Betterment Cost Recovery ("SBCR") mechanism and then a DSIC. They requested that they be
22 allowed to present verbal testimony or allowed additional time to file written testimony on the DSIC
23 issue.

24 On March 11, 2013, RRUI filed a Reply to RUCO's Response and a Reply to the Intervenors'
25 Response/Objection. RRUI objected to the Intervenors' request to file additional testimony during the
26

27 ⁶ On February 21, 2013, RUCO filed a Notice of Errata, that corrected and replaced several pages of Mr. Coley's
surrebuttal testimony.

28 ⁷ A predecessor proposal to the DSIC.

1 first phase of the proposed bifurcated proceeding because it would violate the deadlines established in
2 Procedural Orders and would not give RRUI sufficient opportunity to conduct discovery or prepare.
3 RRUI objected to RUCO's condition to supplement the record in Phase 2 because RRUI believed it
4 would defeat the purpose of bifurcation and would result in re-litigating the cost of equity.

5 On March 12, 2013, Staff filed a Response in Support of Company's Motion to Bifurcate.
6 Staff believed that any proceeding on the DSIC should await the outcome of the decision in the on-
7 going AWC rate case because it was likely that any DSIC approved in the AWC docket would be
8 used as a template for other utilities.

9 By Procedural Order dated March 20, 2013, it was determined that bifurcation of the
10 proceeding as proposed by RRUI was not in the public interest given the issues raised by the parties
11 concerning single issue rate making and the overlap of a DSIC or DSIC-like mechanism with other
12 rate issues. The Procedural Order identified three options for proceeding, including: 1) proceed with
13 the rate case on all issues as currently scheduled; 2) postpone the hearing on all issues until after the
14 Commission's Decision in the AWC DSIC proceeding; or 3) proceed with a process along the lines
15 suggested by RUCO, which would keep the current hearing dates, but also keep the record open to
16 allow parties to file additional testimony on whether a DSIC is appropriate for RRUI, how the DSIC
17 would function, and any effects of the DSIC on other ratemaking elements. Parties were instructed
18 that the issue would be discussed at the March 21, 2013 Pre-hearing Conference.

19 A Pre-hearing Conference convened telephonically on March 21, 2013, to discuss the
20 conduct of the hearing. In response to the ruling in the March 20, 2013 Procedural Order regarding
21 the issue of the DSIC, RRUI withdrew its request for a DSIC in this proceeding. The parties agreed
22 that the pre-filed testimony addressing the DSIC and its predecessor-mechanisms would be
23 withdrawn.⁸

24 The Hearing convened on March 27, 2013, as scheduled, and continued over the following
25 two days, concluding on March 29, 2013. Christopher Krygier, the utility rates and regulatory
26 manager for Liberty Utilities, Greg Sorensen, Vice President and General Manager for Liberty
27

28 ⁸ Transcript of March 21, 2013 Prehearing Conference at 6-8.

1 Utilities and Tom Bourassa, a rate consultant, testified for RRUI; William Rigsby testified for
 2 RUCO;⁹ and John Cassidy, Jian Liu and Gordon Fox testified for Staff. Neither County nor School
 3 District filed written testimony and consequently did not have their own witnesses, but participated in
 4 cross examination.

5 On April 23, 2013, RRUI, RUCO and Staff filed Final Schedules.

6 RRUI, RUCO, Intervenors,¹⁰ and Staff filed Closing Briefs on May 3, 2013.

7 Staff filed its Reply Brief on May 10, 2013; and RRUI and RUCO filed their Reply Briefs on
 8 May 15, 2013. Intervenors did not file a Reply Brief.

9 The Commission received approximately ten written consumer comments (one including a
 10 "petition" of 27 names) objecting to the rate increase. At the commencement of the hearing, the
 11 Commission took public comment and heard from a School District employee about the effect of the
 12 rate increase on the School District, and from a Santa Cruz County Supervisor.¹¹ The over-riding
 13 concern of commenters was the magnitude of the rate increase and the adverse impact on an
 14 economically depressed area. One other member of the public, unaffiliated with any party and not a
 15 customer of RRUI, appeared in person to make comment to address rate design.¹²

16 **II. Summary of the Rate Application**

17 In a rate case it is typical that the parties' positions on rate base, revenue requirement and rate
 18 design, etc., evolve as they engage in discovery and review the positions of the other parties. In this
 19 case, the process of narrowing issues resulted in agreement by the Company, RUCO, and Staff on all
 20 rate base, operating expense and rate design issues, as well as on capital structure. At the hearing the
 21 only issue between these three parties was the cost of capital and the fair value rate of return.¹³ The
 22 County and School District did not reach agreement with the other parties, and contested certain
 23 operating expenses, capital structure and cost of capital.

24

25 ⁹ Mr. Rigsby adopted the testimony of Mr. Coley. Transcript of the March 27-29, 2013 Hearing ("Tr.") at 435-36.

26 ¹⁰ County and School District filed a Combined Opening Brief.

27 ¹¹ Although normally the Commission expects Intervenors to make their positions known through their participation as
 28 parties and does not allow them to also make public comments, in this case, because neither County nor School District
 were presenting witnesses, and were not familiar with Commission practice, the individuals affiliated with the Intervenors
 were allowed to make public comment.

¹² Tr. at 20-26.

¹³ RUCO Closing Brief at 1; Staff Closing Brief at 2; RRUI Initial Closing Brief at 1.

1 In its Rate Application, the Company originally requested a revenue increase of \$604,079 for
 2 its Water Division, which represented a 21.16 percent increase over test year revenues of \$2,854,838.
 3 The Company proposed a rate base of \$7,629,607 for its Water Division, and a rate of return of 9.7
 4 percent, using a pro forma capital structure of 20 percent debt and 80 percent equity.¹⁴ For its
 5 Wastewater Division, RRUI requested a revenue increase of \$393,612, which represented a 28.93
 6 percent increase of over adjusted test year revenues of \$1,360,583. The Company proposed a rate
 7 base of \$4,600,012 for the Wastewater Division, and a rate of return of 9.7 percent based on a pro
 8 forma capital structure of 20 percent debt and 80 percent equity.¹⁵ Initially, the Company was also
 9 requesting a SWIP mechanism, but as discussed above, subsequently withdrew that request.

10 As a final position, RRUI, Staff and RUCO agreed that the Original Cost Rate Base
 11 ("OCRB") for the Water Division should be \$7,731,209.¹⁶ RRUI did not provide Reconstruction
 12 Cost New Less Depreciation data, and thus its Fair Value Rate Base ("FVRB") is deemed to be the
 13 same as its OCRB. For the Wastewater Division, RRUI, Staff and RUCO recommend a FVRB of
 14 \$4,790,738.¹⁷

15 As a final position, RRUI agrees with Staff and RUCO that the Company's actual capital
 16 structure consisting of 100 percent equity should be used to determine its authorized rate of return.
 17 Because these parties recommend employing the actual capital structure of 100 percent equity, their
 18 proposed Cost of Equity ("COE") is also the Company's Weighed Average Cost of Capital
 19 ("WACC") and recommended authorized return. RRUI proposes a fair value return of 9.5 percent.¹⁸
 20 RUCO recommends a fair value return of 8.25 percent.¹⁹ Staff recommends a fair value return of 8.2
 21 percent.²⁰

22 The Intervenors argue that the RRUI's Rate Application should be denied because it does not
 23 comply with the filing requirements set forth in A.A.C. Title 14, Chapter 2, by failing to include the
 24

25 ¹⁴ Ex A-1 Bourassa Rev Req Dir. Sch A-1 (Water). In direct testimony the Company proposed a cost of debt of 5.7
 percent and cost of equity of 10.7 percent for a Weighted Average Cost of Capital of 9.7 percent.

26 ¹⁵ Ex A-1 Bourassa Rev Req Dir at Sch A-1 (Wastewater).

27 ¹⁶ Staff Final Sch MJR-W1; RRUI Final Sch W A-1; RUCO Final Sch TJC-1 (W).

28 ¹⁷ Staff Final Sch MJR-WW-1; RRUI Final Sch A-1 (WW); RUCO Final Sch TJC-1(WW).

¹⁸ Ex A-6 Bourassa COC Rj at 4; RRUI Closing Brief at 12.

¹⁹ Tr. at 151 (Rigsby).

²⁰ Ex S-2 Cassidy Surr at 2.

1 G Schedules regarding a Cost of Service Study ("COSS"). If the Commission does not deny the Rate
 2 Application, the Intervenor's argue as an alternative position, that the proceeding should be delayed
 3 until the Company files the G Schedules and there is an opportunity to vet them in a hearing. As a
 4 second alternative, the Intervenor's argue that if the Rate Application is not denied or delayed, the
 5 new rate increase should be applied proportionately across all rates and charges.²¹

6 In the event that the Commission determines that the Rate Application is sufficient, the
 7 Intervenor's recommend employing a capital structure composed of 50 percent debt and 50 percent
 8 equity, with a cost of debt of 4.13 percent, cost of equity of 8.0 percent, and an authorized return of
 9 6.07 percent.²² If the Commission does not adopt their preferred recommended 50/50 debt/equity
 10 capital structure, the Intervenor's recommend employing RRUI's originally proposed capital structure
 11 consisting of 20 percent debt and 80 percent equity, with a cost of debt of 4.13 percent, and COE of
 12 no more than 8.0 percent, and a WACC of 7.226 percent.²³

13 For the Water Division, a summary of the parties' proposed revenue requirements and
 14 proposed revenue increases follows:

	Revenue Requirement	Revenue Increase	% Increase
15 Company – Direct ²⁴	\$3,458,917	\$604,079	21.6%
16 Staff – Direct ²⁵	\$3,199,993	\$345,155	12.09%
17 RUCO – Direct ²⁶	\$2,987,529	\$90,894	3.14%
18 Company –Rebuttal ²⁷	\$3,360,630	\$581,865	20.94%
19 Staff – Surrebuttal ²⁸	\$3,122,698	\$257,875	9.00%
20 RUCO – Surrebuttal ²⁹	\$3,071,393	\$206,273	8.25%
21 Company – Rejoinder ³⁰	\$3,432,784	\$644,939	23.13%

23
 24 ²¹ Intervenor's Combined Closing Brief at 1-3.

²² Intervenor's Combined Closing Brief at 3-12.

25 ²³ Intervenor's Combined Closing Brief at 11.

²⁴ Ex A-1 Bourassa Rev Req Dir at Sch A-1(W).

26 ²⁵ Ex S-3 Rimback Dir at Sch MJR-W1.

²⁶ Ex RUCO-4 Coley Rev Req Dir at TJC-1(W).

27 ²⁷ Ex A-3 Bourassa Rev Req Reb at 3.

²⁸ Ex S-4 Rimback Surr at Sch MJR-W1.

28 ²⁹ Ex RUCO-6 Coley Rev Req Surr at TLC-1(W).

³⁰ Ex A-5 Bourassa Rev Req at 3.

1	Company – Final³¹	\$3,385,270	\$520,150	18.15%
2	Staff - Final³²	\$3,218,519	\$353,697	12.35%
3	RUCO – Final³³	\$3,224,824	\$359,704	12.55%

4 The Intervenors did not file Final Schedules. For the Water Division, assuming a FVRB of
5 \$7,731,209 (as agreed by the other parties) and an authorized rate of return of 6.07 percent, the
6 required operating income for the Water Division would be \$469,284. Based on test year operating
7 income of \$420,933, the operating income deficiency would be \$48,534, and assuming a gross
8 revenue conversion factor of 1.6589, the required revenue increase under the Intervenors' positions
9 would be \$80,513, or 2.8 percent greater than adjusted test year revenues.³⁴

10 For the Wastewater Division, the parties recommended the following rate increases:

	Revenue Requirement	Revenue Increase	% Increase	
13	Company – Direct ³⁵	\$1,754,195	\$393,612	28.93%
14	Staff – Direct ³⁶	\$1,535,236	\$141,635	10.16%
15	RUCO – Direct ³⁷	\$1,405,272	\$3,060	0.22%
16	Company –Rebuttal ³⁸	\$1,605,670	\$235,540	17.19%
17	Staff – Surrebuttal ³⁹	\$2,522,877	\$120,034	8.56%
18	RUCO – Surrebuttal ⁴⁰	\$1,467,898	\$65,054	4.64%
19	Company - Rejoinder ⁴¹	\$1,649,622	\$279,532	20.40%
20	Company - Final⁴²	\$1,596,136	\$193,293	13.78%
21	Staff - Final⁴³	\$1,492,819	\$89,976	6.41%

22 ³¹ RRUI Final Sch (W) A-1. RRUI's Final Schedules show adjusted test year revenue of \$2,865,120.

23 ³² Staff Final Sch MJR-W1. Staff's Final Schedules indicate adjusted test year revenue of \$2,864,823.

24 ³³ RUCO Final Sch TJC-1 (W). RUCO's Final Schedules reflect adjusted test year revenues of \$2,865,120.

25 ³⁴ These estimates do not include the impact on operating income that would result under Intervenors' pro forma capital structures.

26 ³⁵ Ex A-1 Bourassa Rev Req Dir at Sch A-1 (WW).

27 ³⁶ Ex S-3 Rimback Dir at Sch MJR WW-1.

28 ³⁷ Ex RUCO-4 Coley Rev Req TJC-1 (WW).

³⁸ Ex A-3 Bourassa Rev Req Reb at 3.

³⁹ Ex S-4 Rimback Surr at Sch MJR WW-1.

⁴⁰ Ex RUCO-6 Coley Rev Req Surr TJC-1 (WW).

⁴¹ Ex A-5 Bourassa Rate Base Rj at 3.

⁴² RRUI Final Sch WW A-1.

1 **RUCO - Final⁴⁴** **\$1,496,766** **\$93,922** **6.70%**

2 For the Wastewater Division, the Intervenor’s recommendations would produce a required
3 operating income of \$290,798.⁴⁵ Based on test year adjusted operating income of \$338,603, the
4 Intervenor’s recommendations would result in a revenue decrease of \$47,805, or 3.4 percent, for the
5 Wastewater Division.

6 **III. Is RRUI’s Application Sufficient?**

7 The Intervenor’s state that A.A.C. R14-2-103(B) defines the filing requirements that all
8 utilities must follow when filing an application for a proposed increase in rates or charges. They
9 assert that a Class B Utility, such as RRUI, is required to file COSS G Schedules when: 1) the utility
10 is in a segment of the utility industry that recognizes cost of service studies as important tools for rate
11 design; and 2) costs incurred by the utility are likely to vary significantly from one defined segment
12 of customers to another.⁴⁶

13 Intervenor’s argue that the fact that RRUI filed a COSS in its previous rate case supports the
14 conclusion that RRUI is in a segment of the utility industry that recognizes cost of service studies as
15 important tools for rate design, and acknowledges that the costs incurred by RRUI are likely to vary
16 significantly from one defined segment of customers to another.⁴⁷ The Intervenor’s argue further that
17 because RRUI is the same utility in this case as it was in the last case, RRUI is required to file the G
18 schedules; and the failure to file G Schedules violates the filing requirements of R14-2-103(B) and
19 results in an application that is insufficient on its face.

20 RRUI argues that Intervenor’s claim that a COSS is required is untimely.⁴⁸ The Company
21 asserts that a Motion to Dismiss of this kind should be brought at the outset of the case, or at least at
22 the time of intervention. RRUI argues that because Intervenor’s waited until after the evidence was
23

24 _____

25 ⁴³ Staff Final Sch MJR-WW1.
26 ⁴⁴ RUCO Final Sch TJC-1 (WW).
27 ⁴⁵ The agreed FVRB of \$4,790,738 x 0.0607.
28 ⁴⁶ A.A.C. R14-2-103.
⁴⁷ Intervenor’s Combined Opening Brief at 1. Intervenor’s asserted that RRUI filed a COSS in its last rate case, based on the testimony of Mr. Bourassa in this case (Tr. at 411), but RRUI states that records show that RRUI did not file a COSS in its last rate case, and that Mr. Bourassa misspoke on the stand. RRUI Reply Closing Brief at 8, fn 35.
⁴⁸ RRUI Reply Closing Brief at 6.

1 presented, they should be deemed to have waived any such claim.⁴⁹ In addition, RRUI states that the
 2 Commission has delegated to Staff the determination of whether an application meets its filing
 3 requirements.⁵⁰ The Company notes that in this case, Staff found that the Rate Application was
 4 sufficient on July 3, 2012, which equates to a finding by Staff that the G Schedules were neither
 5 necessary nor required in this case. RRUI argues that Intervenors could have petitioned the
 6 Commission to reconsider Staff's sufficiency finding, but did not, and thus, Staff's finding of
 7 sufficiency, without the G Schedules must stand.

8 RRUI also claims that it is not unusual for water and wastewater company rate applications to
 9 be filed and decided without a COSS. The Company states that Liberty Utilities filed and received
 10 several rate orders in Arizona since it acquired its first public service corporation in 2001, and only a
 11 couple of those cases contained the G Schedules, and none were dismissed for lack of a COSS.⁵¹
 12 RRUI also asserts that often rate applications are decided by this Commission without G Schedules
 13 and currently, there are several pending rate cases in which the applicant did not file G Schedules.⁵²

14 RRUI asserts that the cost of performing a COSS is one of the reasons that they are not
 15 always performed. In this case, the Company notes that it and RUCO agreed to adopt Staff's rate
 16 design, and neither Staff nor RUCO felt that a COSS was needed, either as a requirement of the
 17 application, or to support rate design. RRUI states that either Staff or RUCO could have submitted
 18 their own COSS if they believed one was necessary.

19 Staff asserts that no evidence was presented in this case that costs incurred by RRUI are likely
 20 to vary significantly between customer segments.⁵³ Staff disagrees with the Intervenors' conclusion
 21 that filing a COSS in a previous rate case, means that a company: 1) is in a segment of the utility
 22 industry that recognizes that cost of service studies are important tools for rate design; or 2) the costs
 23 incurred by the utility are likely to vary by customer class. Staff asserts that RRUI may have opted
 24

25 ⁴⁹ *Citing, Douglas v. Mundell*, 2009 WL 2766746 at *5 (Ariz. App. 2009), and *Westin Tucson Hotel Co. v. Ariz. Dep't of*
 26 *Rev.*, 183 Ariz. 360, 364; 936 P.2d 183, 187 (App. 1997); RRUI Reply Closing Brief at 7.

26 ⁵⁰ A.A.C. R14-2-103.B.7 provides that after a rate application is filed, Staff has 30 days to determine sufficiency.

27 ⁵¹ RRUI Reply Closing Brief at 7.

27 ⁵² RRUI Reply Closing Brief at 8; Global Water-Palo Verde Utilities Company, Docket No. WS-20445A-12-0310 and
 28 Far West Water & Sewer, Inc., Docket No. WS-03478A-12-0307.

28 ⁵³ Staff Reply Brief at 2.

1 for a COSS in the last case for reasons other than a significant difference between costs among
 2 customer segments. Staff states further that a COSS is relevant primarily in addressing rate design
 3 issues, but rate design is not a disputed issue in this proceeding—even for Intervenors.⁵⁴ Furthermore,
 4 Staff argues that Intervenors had opportunity to raise the issue, or engage in discovery, at or before
 5 the hearing, but failed to do either.

6 Intervenors did not raise their claim about the sufficiency of RRUI's Rate Application until
 7 they filed their closing brief. They could have raised the issue at the time that they sought
 8 intervention or at the pre-hearing conference, or any time in between. To wait until the conclusion of
 9 the evidentiary hearing to raise a claim of sufficiency is unreasonable, and inconsistent with judicial
 10 efficiency. We find that by not raising the issue earlier Intervenors waived this claim.

11 Moreover, the Commission's Rules delegate the authority to determine sufficiency of an
 12 application to Staff, and the Commission relies on Staff's expertise to determine when an application
 13 is sufficient. Often Staff will conclude that a rate application is sufficient for water and wastewater
 14 companies when the applicant has not filed a COSS; and the Commission often makes determinations
 15 of just and reasonable rates without a COSS. At no time in this proceeding, did any party claim that
 16 information contained the G Schedules is necessary to a decision in this matter. Not even Intervenors
 17 make that claim. There is no indication that RRUI's cost of serving its various rate classes varies
 18 significantly such that a COSS is necessary to set rates in this case. Consequently, we deny the
 19 Intervenors' request to delay this proceeding.

20 **IV. Rate Base**

21 In its Rate Application, the Company proposed a FVRB of \$7,629,604 for the Water Division
 22 and \$4,600,312 for the Wastewater Division. By the time RRUI filed its rejoinder testimony, there
 23 was only one rate base issue in dispute—how RRUI was accounting for retired plant and its
 24 depreciation of fully depreciated or retired plant. Initially, Staff expressed concerns that the
 25 Company was recording depreciation expense on plant that had been fully depreciated, which
 26 affected the depreciation expense and accumulated depreciation balances. RRUI, Staff and RUCO
 27

28 ⁵⁴ Staff Reply Brief at 2.

1 each proposed an adjustment to correct the retired plant issue using a different methodology and the
2 issue remained unresolved.⁵⁵

3 This issue arose because of poor record keeping by RRUI's predecessor.⁵⁶ RRUI and Staff
4 agreed to resolve this issue consistent with the resolution of a similar issue affecting the Bella Vista
5 Water Company.⁵⁷ RUCO ultimately agreed to the FVRB resolution worked out between Staff and
6 RRUI. The resolution among the three parties results in (1) a finding of fair value rate base equal to
7 \$7,731,209 (Water), and \$4,790,738 (Wastewater); (2) a level of depreciation expense equal to
8 \$441,453 (Water) and \$223,774 (Wastewater) which the parties agree eliminates potential
9 overstatement or over-recovery by the Company.⁵⁸ In addition, in order to ensure that the Company
10 remedies the problem permanently, RRUI has been put on notice that a repeat of this issue could
11 result in the imposition of penalties.⁵⁹

12 For the Water Division, RRUI, RUCO and Staff agree on the following components of rate
13 base:

14	Utility Plant-In-Service	\$34,454,989
15	Accumulated Depreciation	\$13,754,657
16	Net Utility Plant	\$20,700,332
17	Advances in Aid of Construction	\$660,955
18	Contributions in Aid of Construction	\$20,179,119
19	CIAC – Amortization	\$8,617,752
20	Customer Meter Deposits	\$284,084
21	ADIT	\$462,717
22	Total Rate Base	\$7,731,209

23 For the Wastewater Division, RRUI, RUCO and Staff agree on the following:
24

25 ⁵⁵ Ex A-3 Bourassa Rev Req Reb at 6. Staff Closing Brief at 3.

⁵⁶ Ex A-3 Bourassa Rev Req Reb at 8; Ex A-5 Bourassa Rj at 10

26 ⁵⁷ Ex A-3 Bourassa Rev Req Reb at 7-8; Ex A-5 Bourassa Rj at 7; RRUI Initial Closing Brief at 4; Staff Closing Brief at
3; Tr. at 34 (Krygier); See Decision No. 72251 (April 4, 2011). Bella Vista Water Co. is also owned by Liberty Utilities.

27 ⁵⁸ Tr. at 440 (Rigsby) and at 540 (Fox). RRUI and RUCO accepted Staff's adjustments to Depreciation Expense of
\$109,768 for the Water Division and \$135,855 for the Wastewater Division. Staff Reply Brief at 1; See also Final
Schedules.

28 ⁵⁹ RRUI Initial Opening Brief at 5; Staff Closing Brief at 3.

1 **A. Pension Plan**

2 The issue concerning employee benefits involved a new employee benefit plan that was
3 announced late in 2012, (after the start of this rate case), and implemented as of January 1, 2013,
4 (after the end of the test year). In its rebuttal testimony, the Company proposed a pro forma
5 adjustment of \$32,891 for the Water Division and \$11,811 for the Wastewater Division for the
6 allocation of pension plan expenses.⁶² Staff initially opposed the pro forma adjustments because
7 Staff believed that RRUI had failed to sufficiently document certain items and because Staff claimed
8 that it did not have a reasonable opportunity to evaluate the plan.⁶³ However, during the hearing,
9 RRUI, Staff and RUCO agreed that a total expense level of \$32,891 for the Water Division and
10 \$11,811 for the Wastewater is fair and reasonable.⁶⁴ In addition, in order to ensure that the Company
11 does not fail to contribute to the pension plan in 2013 as intended, RRUI agreed to: (1) make a
12 compliance filing reflecting that the pension fund payments have been made in 2013; and (2) an
13 accounting order that would allow it to track any amounts that are lower than the amounts authorized
14 in this case.⁶⁵

15 Intervenors argue that the pro forma employee benefit adjustment should be rejected because
16 the expense is out-of-test year and not auditable as it still has not been incurred. In addition, they
17 argue that RRUI was unable to provide any information or documentation supporting these expenses
18 as they relate to RRUI, and that the adjustments fail the “known and measurable” standard. In their
19 closing brief, Intervenors assert that there is no third-party documentation supporting its applicability
20 to RRUI because there is no evidence linking the Cottonwood Group’s services with RRUI’s
21 spreadsheet showing the expense for each employee.⁶⁶ Intervenors argue that although the Company
22

23 ⁶² Ex A-8 Sorensen Reb at 6; Ex A-9 Sorensen Rj at 5; Ex A-3 Bourassa Rev Req Reb at 33 and 46.

24 ⁶³ Ex S-4 Rimback Surr at 16 and 19.

25 ⁶⁴ Tr. at 394 (Sorensen); Tr. at 440 (Rigsby); Tr. at 450 (Fox).

26 ⁶⁵ Ex A-17, n 1. The Company states that it is its understanding that the accounting order would create a regulatory
27 liability in the event of major changes in the level of pension funding. The Company states, however, that it does not
28 believe that it should face a liability for fluctuations in the annual amount of pension contributions that arise strictly from
changes in personnel, any more than it would expect a regulatory asset to be created if pension contributions were to
increase each year for the next few years between rate cases. The Company states that the goal of the regulatory liability
is to create assurances to RUCO that the expense would be incurred at the level authorized in rates, and if not, captured on
the balance sheet accordingly. Tr. at 394 (Sorensen) and 403 (Krygier). See RRUI Initial Opening Brief at 6, n 29.

⁶⁶ The Cottonwood Group provided actuarial, administrative and consulting services to Liberty Utilities regarding the
pension plan. Confidential Ex RUCO-3.

1 provided a spread sheet listing employee names and the amount of the alleged employee benefits
2 expenses, it provided no supporting documentation of how they arrived at the alleged figures. They
3 state that at the hearing RRUI was only able to provide a contract for services between Liberty
4 Energy Utilities and the Cottonwood Group for pension consulting services. Intervenors state that
5 Liberty Energy Utilities is a separate legal entity, and RRUI was unable to produce any evidence that
6 the Liberty Energy Utilities Contract with the Cottonwood Group applied to, or included, RRUI.⁶⁷
7 Intervenors argue that RRUI failed to produce any plan by the Cottonwood Group recommending
8 employee benefit payments to the individuals claimed in RRUI's pro forma adjustment.

9 RRUI argues that pro forma adjustments, such as the pension plan costs in this case, are not
10 only authorized by the Commission's Rules, but are common and necessary to properly reflect a
11 utility's costs of providing service during the time the new rates will be in effect.⁶⁸ RRUI asserts that
12 there can be no legitimate dispute that Liberty Utilities is implementing a pension plan in 2013. The
13 Company asserts that the pension plan is a critical component of its ability to attract qualified
14 personnel, and the pension costs are known and measurable. In response to the Intervenors' claim
15 that there is no evidence that the plan applies to Liberty Utilities, RRUI cites the testimony of Mr.
16 Sorensen explaining the plan and its applicability to Liberty Utilities.⁶⁹ Moreover, the Company
17 asserts that the ratepayers are fully protected in this case because the Company has agreed to a
18 mechanism that would create a customer credit in the next rate case in the event that the pension plan
19 is not funded in 2013.

20 Staff disagreed with Intervenors' position objecting to the pro forma employee benefit
21 adjustment because although at the time of the hearing the written plan was still being prepared for
22 RRUI, the evidence indicates that the plan is a national plan applicable to RRUI's affiliates; the
23 Company provided details about the names of employees to receive benefits and the anticipated
24 amounts thereunder; and the Company testified about the annual cost of the plan, including payments
25 to be made in 2013.⁷⁰

26 ⁶⁷ Ex Santa Cruz County-5.

27 ⁶⁸ RRUI Reply Closing Brief at 9.

28 ⁶⁹ Ex A-8 Sorensen Rb at 5-7; Tr. at 361-364, 393-395 (Sorensen); and late-field confidential exhibits filed with the closing briefs.

⁷⁰ Tr. at 281, 287-288, 261-363. Staff's Reply Brief at 4-5.

1 On May 3, 2013, (with its Initial Closing Brief), RRUI provided a confidential Summary of
2 Liberty Utilities' Cash Balance Pension Plan (Effective January 1, 2013). On May 15, 2013, RRUI
3 provided a copy of Liberty Utilities' Cash Balance Pension Plan signed by the Chief Executive
4 Officer of APUC, the ultimate parent of RRUI.⁷¹ These documents indicate that the pension plan
5 applies to Liberty Utilities Co., as the sponsor, and Liberty Water as the Employer, and any person
6 employed by the Employer or an Affiliate. As a subsidiary of Liberty Water, RRUI would be an
7 affiliate. Although at the time of the hearing, RRUI did not have access to the final pension plan
8 agreement, the evidence shows that Liberty Water and RRUI employees are covered by the pension
9 plan. Commission Rules allow for pro forma adjustments to test year results in order to obtain a
10 normal or more realistic relationship between revenues, expenses and rate base.⁷² The cost of the
11 pension plan is known and measureable, and is an appropriate pro forma expense as the pension plan
12 applies to test year employees and costs will be incurred during the time the new rates go into effect.
13 If for some reason, the pension plan costs are not incurred at the level anticipated, RRUI ratepayers
14 will be protected by the creation of a regulatory liability. The pension plan costs approved are for
15 current employees, and any increased pension costs attributed to future employees are not being
16 collected in the rates we approve herein, nor are we approving an accounting order that would allow
17 RRUI to seek future recovery of pension plan costs incurred between rate cases attributable to future
18 employees, or even to increased costs attributed to current employees. The accounting order in this
19 case is solely to protect ratepayers in the event that the pension plan is not funded as anticipated. It is
20 not an adjustor type mechanism to recover increased pension plan costs. Consequently, we adopt the
21 positions of RRUI, RUCO and Staff concerning pension plan costs, which include \$32,891 for the
22 Water Division and \$11,811 for the Wastewater Division.

23 **B. Incentive Pay**

24 In pre-filed testimony, RUCO recommended adjustments to wages and salary expense of
25 \$19,997 for the Water Division and \$9,448 for the Wastewater Division, for incentive pay.⁷³ RUCO
26

27 ⁷¹ RRUI stated that the Plan is not available to the public and requested that it be treated as "confidential."

⁷² A.A.C. R14-2-103.

28 ⁷³ Ex RUCO-4 Coley Rev Req Dir at 10 and 48; Sch TJC-11 (W) and (WW). Staff did not make a similar adjustment.

1 recommended a 50/50 sharing of the incentive pay expenses between ratepayers and shareholders.⁷⁴
 2 The Company countered that the incentive pay expense was part of Liberty Water's compensation
 3 plan and important in attracting the most qualified personnel.⁷⁵ The Company argued that the
 4 incentives are based on metrics such as "Customer Experience, Employee programs, Operational
 5 Excellence, Safety, Efficiency and personal performance."⁷⁶ At the hearing, RUCO agreed to drop
 6 this adjustment.⁷⁷

7 For purposes of this rate case, we accept the parties' positions that incentive pay is at an
 8 appropriate level in this case. The evidence supports a finding that it is a part of the basic
 9 compensation package for employees and provides benefits to rate payers. Staff's testimony always
 10 supported its inclusion. However, our adoption of this expense item at this level as part of a
 11 "settlement-like" arrangement among the parties should not be interpreted as limiting our ability to
 12 evaluate this expense item, and its allocation between ratepayers and shareholders, in future rate
 13 cases.

14 **C. Nogales Wastewater Treatment Plant Expense**

15 Most of RRUI's wastewater customers are serviced by the NWWTP which is owned by the
 16 City of Nogales, but operated by the International Boundary Water Commission ("IBWC"). RRUI
 17 contracts with the City of Nogales for use of the plant facilities.

18 In its Rate Application, the Company utilized the test year level of expenses related to the
 19 NWWTP of \$165,896 (\$13,829 per month) for the cost of the operation and maintenance of the plant.
 20 RRUI and the City of Nogales entered into an agreement that resulted in retroactive reductions to the
 21 test year level of expense, reducing the monthly cost to \$9,083.⁷⁸ Because the Company had been
 22 paying \$9,083 per month since February 2012, RUCO adjusted the test year operating expense to
 23 reflect this amount.⁷⁹

24
 25
 26 ⁷⁴ Ex RUCO-4 Coley Rev Req Dir at 10 and 45; Ex RUCO-6 Coley Rev Req Surr at 22.

⁷⁵ Ex A-8 Sorensen Reb at 4-5; Ex A-9 Sorensen Rj at 2-3.

⁷⁶ Ex A-8 Sorensen Reb at 5.

⁷⁷ Ex A-17.

⁷⁸ Ex RUCO-6 Coley Surr at 35-36; RUCO Reply Brief at 2.

⁷⁹ Staff did not raise this issue in pre-filed testimony.

1 The contract with the City of Nogales is subject to true-up depending on the actual cost of
 2 operating the plant. RRUI asserts that the City of Nogales has not always reconciled the annual
 3 amounts in a timely manner which created uncertainty surrounding the test year level of expense and
 4 whether there may be a lump sum payment due in the future as a result of the true-up process.⁸⁰

5 Ultimately, RRUI, RUCO and Staff agreed to utilize RUCO's recommended expense level for
 6 the NWWTP based on the amount that the Company is currently paying, and that an accounting order
 7 should be issued allowing RRUI to track any additional amounts it is required to pay for treatment
 8 after the City of Nogales trues-up the charges.⁸¹ The result is that in a future rate case, the Company
 9 can seek to recover any additional amounts paid to the City of Nogales as a regulatory asset, or if the
 10 costs decrease, the customers would receive the benefit of a regulatory liability.⁸² In addition, the
 11 Company agreed that it will not seek deferred or accrued carrying costs or interest on additional
 12 amounts paid to the City of Nogales for the NWWTP.⁸³ RUCO's adjustment decreased the NWWTP
 13 annual expense by \$56,897, from \$165,896 to \$108,999.

14 The parties' agreed treatment for the expenses associated with the NWWTP is reasonable. At
 15 the time of the hearing RRUI was paying \$9,083 a month to the City of Nogales. In a letter from the
 16 City of Nogales to RRUI dated March 26, 2013, it appears that RRUI will incur this level of expense
 17 through the end of 2013.⁸⁴ RRUI does not have control over the expenses of the NWWTP. In the
 18 annual true-up process, the expense may be further adjusted, up or down, by the IBWC and City of
 19 Nogales. Because the cost of operating the NWWTP is a necessary cost of providing service, it is
 20 reasonable that RRUI track any changes in the contract price in the period between rate cases. RRUI
 21 would then be allowed to seek recovery of any increased costs as a result of the true-up of the
 22 contract. Likewise, if costs are lower than those recognized herein, ratepayers should receive the
 23 benefit of the contract true-up. The Commission will determine at the time RRUI files its request
 24

25 ⁸⁰ Ex A-5 Bourassa Rj at 29.

26 ⁸¹ Ex A-17, n 4.

27 ⁸² RRUI Initial Opening Brief at 8. The Company states that it is its understanding that it is possible it will pay lower
 amounts and that a regulatory liability would be created and further that neither RUCO nor Staff are waiving their rights
 to object to the recovery of amounts tracked per the accounting order in a future rate case. Tr. at 406 (Krygier).

28 ⁸³ Tr. at 376 (Sorensen).

⁸⁴ Ex Santa Cruz County-2, Tr. at 332-336 (Sorensen).

1 whether, and how, to grant the request to recover or refund any additional costs or reductions
2 incurred between rate cases.

3 **D. Amortization of Rate Case Expense**

4 RRUI, RUCO and Staff agreed on a total Rate Case Expense of \$350,000, allocated between
5 the two divisions based on customer numbers.⁸⁵ Initially, RRUI and Staff utilized a three year
6 amortization/normalization schedule, while RUCO recommended a four year schedule. RRUI argued
7 that the three year schedule reflects Liberty Water's policy to bring its companies in for rate increases
8 in roughly three-year intervals and RRUI's history under Liberty Water ownership.⁸⁶ RUCO
9 ultimately agreed to a three year schedule, and all parties agree that the annual expense level of
10 \$87,500 for the Water Division and \$29,167 for the Wastewater Division is fair and reasonable.⁸⁷

11 A three year normalization period is reasonable based on RRUI's history of applying for rate
12 adjustments. The rate case amount of \$350,000 appears reasonable given the size of the utility and
13 number of issues addressed. We adopt the recommendations of the parties.

14 **E. Declining Usage Adjustment and Purchased Power Adjustment**

15 The Company claims that it has experienced declining revenues from water sales under the
16 rate designs approved in recent rate cases.⁸⁸ In its rebuttal testimony, RRUI proposed reducing test
17 year revenue by \$77,275 for the Water Division and \$32,713 for the Wastewater Division to account
18 for the declining sales.⁸⁹ In addition, the Company noted that its electric provider UNS Electric has
19 filed an application with the Commission for a rate increase, which will increase RRUI's cost of
20 service.⁹⁰ The Company proposed a purchased power adjustment of \$17,083 for the Water Division
21 and \$2,819 for the Wastewater Division.⁹¹ Staff and RUCO recommended against these adjustments,
22 and the Company withdrew both of these proposed adjustments.⁹²

23
24 ⁸⁵ Ex A-1 Bourassa Rev Req Dir at 11. RRUI Initial Opening Brief states that the rate case expenses were \$335,000. This
25 appears to be a misstatement. RRUI Initial Opening Brief at 8.

⁸⁶ Ex A-3 Bourassa Rev Req Reb at 34-35; Ex A-5 Bourassa Rev Req Rj at 24.

26 ⁸⁷ Tr. at 440 (Rigsby) and 450 (Fox).

⁸⁸ RRUI Initial Opening Brief at 8.

27 ⁸⁹ Ex A-3 Bourassa Rev Req Reb at 29 and 41.

⁹⁰ Ex A-3 Bourassa Rev Req Reb at 32.

⁹¹ Ex A-3 Bourassa Rev Req Reb at Sched C-1 2.1 (W) and (WW).

28 ⁹² RRUI Initial Opening Brief at 8.

1 The Company has determined not to pursue these adjustments. We accept that decision. We
 2 note that the rates that will result from the pending UNS Electric rate case were not known and
 3 measurable at the time of this proceeding and thus, a pro forma adjustment would not have been
 4 appropriate.⁹³

5 **VI. Cost of Capital**

6 In their final positions, RRUI, RUCO and Staff utilized the Company's actual capital structure
 7 of 100 percent equity. Thus, for these parties, their recommended COE is equivalent to the WACC
 8 and their recommended fair value rate of return. The Intervenors recommend utilizing a pro forma
 9 capital structure and a fair value rate of return equal to the calculated WACC.

10 RRUI proposed a COE of 9.5 percent; RUCO recommended a COE of 8.25 percent; Staff
 11 recommended a COE of 8.2 percent; and Intervenors recommended a COE of not more than 8.0
 12 percent, a cost of debt of 4.13 percent, and a WACC ranging between 6.07 percent and 7.226 percent
 13 depending on the pro forma capital structure utilized.

14 **A. RRUI**

15 As a final position, RRUI utilized the Company's actual capital structure, and argued that the
 16 choice between the hypothetical and actual capital structure was not material because while the use of
 17 a pro forma capital structure would include interest synchronization, which would lower operating
 18 expenses, it would increase the cost of equity because of greater financial risk, thus effectively
 19 offsetting the benefit of the interest synchronization.⁹⁴

20 Because RRUI is not publicly traded, there is no market data specific to RRUI. As a result,
 21 RRUI's cost of capital witness, Mr. Bourassa, used the Discounted Cash Flow ("DCF") model and
 22 Capital Asset Pricing Model ("CAPM") to estimate a cost of equity for RRUI based on a sample of
 23 water utilities selected from the *Value Line* Investment Survey ("*Value Line*").⁹⁵ Mr. Bourassa's DCF
 24 analyses indicated returns on equity ("ROEs") in the range of 8.6 percent to 9.7 percent with a
 25 midpoint of 9.2 percent.⁹⁶ His CAPM analysis indicated ROEs in the range from 8.6 percent to 12.7

26 ⁹³ See Docket No. E-04204A-12-0508 filed December 31, 2012. Currently, the hearing in the UNS Electric matter is set
 to commence September 30, 2013.

27 ⁹⁴ RRUI Initial Opening Brief at 9.

⁹⁵ Ex A-2 Bourassa COC Dir at 3.

28 ⁹⁶ Ex A-6 Bourassa Rj at Sch D-4.1.

1 percent with a midpoint of 10.6. The average of the midpoints of Mr. Bourassa's DCF and CAPM
2 analyses is 9.8 percent, which he then adjusted lower by 0.9 percent to account for the lower financial
3 risk in a 100 percent equity capital structure, and adjusted upward by 0.8 percent for his "Small
4 Company Risk Premium."⁹⁷ The result of Mr. Bourassa's adjustments was a COE of 9.8 percent,
5 which he further reduced to a recommended return of 9.5 percent to be "conservative."⁹⁸

6 The DCF model uses comparable risk companies and estimates the cost of capital directly,
7 and rests on the premise that the fundamental value of an asset (stock) is its ability to generate future
8 cash flows. The DCF is the sum of a stock's expected dividend yield and the expected long-term
9 growth rates.⁹⁹ For his DCF growth estimate, Mr. Bourassa used analyst growth forecasts and the 5-
10 year historical average growth rates in the stock price, book value per share ("BVPS"), dividends per
11 share ("DPS") and earnings per share ("EPS").¹⁰⁰

12 The CAPM formula uses a risk-free rate plus a risk premium and quantifies the additional
13 return investors require for bearing incremental risk.¹⁰¹ Mr. Bourassa used long-term Treasury rates
14 for the risk-free rate. The CAPM requires calculating a "beta" which is a measure of the relative risk
15 of a security in relation to the market.¹⁰² Because RRUI is not publicly traded, RRUI doesn't have a
16 beta, so the beta of the sample group is used as a proxy. Mr. Bourassa calculated a beta of 0.72 for
17 RRUI. Mr. Bourassa prepared two calculations for the market risk premium estimates: an historical
18 market risk and a current market risk.¹⁰³ The historical market risk premium is based on the average
19 premium of the market over long-term securities from 1926 through 2011. For the current market risk
20 premium, Mr. Bourassa first used the DCF model to compute an expected market return for the past
21 12 months then subtracted the 30-year Treasury yield.¹⁰⁴

22 RRUI argues that Staff's and RUCO's recommended ROEs of 8.2 and 8.25 percent,
23 respectively, are too low and cannot pass the comparable earnings standard established in *Bluefield*

24
25 ⁹⁷ Ex A-6 Bourassa COC RJ at Sch D-4.1

⁹⁸ Tr. at 103 (Bourassa).

26 ⁹⁹ Ex A-2 Bourassa COC Dir at 25-26.

¹⁰⁰ Ex A-2 Bourassa COC Dir at 30-33.

27 ¹⁰¹ Ex A-2 Bourassa COC Dir at 32.

¹⁰² Ex A-2. Bourassa COC Dir at 33.

¹⁰³ Ex A-2 Bourassa COC Dir at 36.

28 ¹⁰⁴ Ex A-2 Bourassa COC Dir at 36.

1 *Water Works and Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679,
2 692-93 (1923) and *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

3 RRUI argues that in the *Bluefield* and *Hope* decisions, the United States Supreme Court
4 established a “comparable earnings” standard to determine if state regulators are adopting a
5 reasonable return for utility companies. In *Bluefield*, the Court held:

6 A public utility is entitled to such rates as will permit it to earn a return on
7 the value of the property which it employs for the convenience of the
8 public equal to that generally being made at the same time and in the same
9 general part of the country on investments on other business undertakings
10 which are attended by corresponding risks and uncertainties.... The return
11 should be reasonably sufficient to assure confidence in the financial
12 soundness of the utility and should be adequate, under efficient and
13 economical management, to maintain and support its credit and enable it
14 to raise money necessary for the proper discharge of its public duties. A
15 rate of return may be reasonable at one time and become too high or too
16 low by changes affecting opportunities for investment, the money market,
17 and business conditions generally.¹⁰⁵

18 The Court further held that “[r]ates which are not sufficient to yield a reasonable return on the value
19 of the property used at the time it is being used to render the service are unjust, unreasonable and
20 confiscatory, and their enforcement deprives the public utility company of its property in violation of
21 the Fourteenth Amendment.”¹⁰⁶

22 In *Hope*, the United States Supreme Court found:

23 [T]he return to the equity owner should be commensurate with returns on
24 investments in other enterprises having corresponding risks. That return,
25 moreover, should be sufficient to assure confidence in the financial
26 integrity of the enterprise, so as to maintain its credit and to attract
27 capital.¹⁰⁷

28 RRUI claims that RUCO and Staff believe their recommendations meet the legal
requirements because Staff and RUCO have compared RRUI to proxy utilities. RRUI argues,
however that just because a DCF or CAPM analysis produces a value, it does not mean that the result
is reasonable or credible. RRUI asserts that if the models result in returns on equity that do not allow

¹⁰⁵ *Bluefield*, 262 U.S. at 692-93.

¹⁰⁶ *Bluefield*, 262 U.S. at 690.

¹⁰⁷ *Hope*, 320 U.S. at 603.

1 the utility to attract capital and maintain its value, then the returns should not be approved and there
2 might be something wrong with the comparative analysis.¹⁰⁸

3 RRUI asserts that it is undisputed that: (1) as of January 18, 2013, *Value Line* projects the
4 expected average return on equity for the proxy group of water utilities to be 10.3 percent; (2) as of
5 December 7, 2012, *Value Line* projected the average expected returns on equity for the sample gas
6 utilities to be 11.5 percent; that as of January 2013, the currently authorized ROE's for the sample
7 water utilities companies as reported by *AUS Utility Reports* is 10.03 percent; and (4) the currently
8 authorized ROEs for the sample natural gas distribution companies as reported by AUS as of January
9 2013, is 10.29 percent.¹⁰⁹ RRUI argues that Staff's and RUCO's recommended authorized returns
10 are 178 to 183 basis points lower than the average of the currently authorized ROEs for the proxy
11 water utilities; 204 to 209 basis points lower than the average of the currently authorized ROEs for
12 the proxy gas companies. RRUI asserts that these results support a conclusion that Staff's and
13 RUCO's recommended returns are not credible.

14 RRUI states that a major difference between RRUI and the proxy group of water companies
15 used in the models is the size difference, with the average net plant and revenues of the proxy group
16 many times greater than RRUI's.¹¹⁰ Secondly, RRUI states that the proxy group's stock is publicly
17 traded and can be sold within minutes, while RRUI's owner cannot liquidate its ownership quickly.
18 RRUI claims that the difference in liquidity risk between RRUI and the sample companies is so
19 significant that it equals or exceeds the difference in financial risk.¹¹¹ RRUI believes that publicly
20 traded utility holding companies that are geographically more diverse and that enjoy economies of
21 scale, benefit from greater revenue and earnings stability than a small utility. It asserts that investing
22 in the publicly traded utility is less risky because business risks are lower. RRUI believes that it
23 borders on the "absurd" to claim, by recommending a rate of return 210 to 300 basis points lower,
24 that a small company like RRUI is a safer investment than an investment in the sample companies.¹¹²

25 ¹⁰⁸ RRUI Initial Opening Brief at 12.

26 ¹⁰⁹ RRUI Initial Opening Brief at 13-14.

27 ¹¹⁰ RRUI Initial Opening Brief at 15. According to RRUI's chart, the average proxy group's net plant is \$1.229 billion
28 compared to RRUI's net plant of \$28.1 million, and the average proxy group revenue of \$344 million versus RRUI's
revenue of \$4.2 million.

¹¹¹ RRUI's Initial Opening Brief at 16.

¹¹² RRUI's Initial Opening Brief at 16.

1 RRUI asserts that Staff and RUCO are recommending ROEs that are completely unrelated to the data
2 from their own proxy group.

3 In addition, RRUI asserts that in order for the Company to pay dividends if the Staff or
4 RUCO recommended ROEs are adopted, the dividend payout ratio required to meet investor
5 expectations will be at or near 100 percent of earnings (94 percent under Staff's and 93 percent under
6 RUCO's), which RRUI claims is not sustainable.¹¹³ RRUI states that under its recommended ROE,
7 the dividend payout ratio is 71 percent, which is the same as the five-year average dividend payout
8 ratio for the sample companies.¹¹⁴ RRUI claims that if the Company is forced to exist with the high
9 dividend payout ratios that result from the Staff and RUCO recommendations, the value of the equity
10 investment in RRUI would decrease, further increasing risk. RRUI argues that a cost of capital that
11 reduces the entity's value is not likely to attract capital and fails the critical elements of the
12 comparable earnings test.

13 In response to criticism that Mr. Bourassa relied too heavily on analyst forecasts or forecasted
14 interest rates in his models, RRUI argues that the Commission should consider analysts' projections
15 and expectations when setting ROE because the rate of return that is being calculated is going to be in
16 effect in the future.¹¹⁵ Moreover, RRUI states that Mr. Bourassa incorporated historical growth rates
17 into his growth estimates and the DCF model and spot rates into the estimate of the risk-free rate in
18 his CAPM.¹¹⁶ In an attempt to avoid the arguments over the proper inputs to the DCF and CAPM
19 analyses, RRUI also employed the build-up method to estimate a reasonable COE.¹¹⁷ RRUI states
20 that because it utilizes objective data from *Morning Star* and *Duff & Phelps*, the build-up method is a
21 reasonable comparative benchmark against which to compare the DCF and CAPM results.¹¹⁸ RRUI
22 claims that the build-up method demonstrates that the cost of equity for smaller firms is not a unique
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24 ¹¹³ Ex A-18 at Table 1 and Table 2. RRUI's Initial Opening Brief at 18.

25 ¹¹⁴ Ex A-18 at Table 3; Ex A-6 Bourassa COC RJ at 12.

26 ¹¹⁵ RRUI Reply Closing Brief at 20.

27 ¹¹⁶ Ex A-2 Bourassa COC Dir at 31-32. RRUI Reply Closing Brief at 21.

28 ¹¹⁷ According to Mr. Bourassa, the build-up method is an additive model in which the return on a security is the sum of the risk free rate and one or more risk premia. Using information from *Morning Star* and *Duff & Phelps*, Mr. Bourassa calculated a risk free rate and added risk premia for financial risk and company specific risk. Ex A-2 Bourassa COC Dir at 38-44.

¹¹⁸ RRUI Reply Closing Brief at 22.

1 risk as argued by Staff, but another market risk factor that explains the differences in returns between
2 large and small firms.¹¹⁹

3 Finally, RRUI argues that it is impossible for an ROE of 8.2 or 8.25 to pass any reasonable
4 comparative earnings test when the investor would be better off putting his money in any average
5 stock (9.4 percent three-year average), three-year treasuries (9.16 percent annualized return), or even
6 corporate bonds (8.23 percent average).

7 B. RUCO

8 RUCO recommends an 8.25 percent COE which includes a 50 basis point adjustment for the
9 reduced financial risk associated with the absence of debt in the Company's capital structure.¹²⁰
10 RUCO utilized the DCF and CAPM to determine its recommended COE, and asserts that the
11 methodology it used to calculate the COE are the methodologies to which the Commission has given
12 the most weight in setting allowed rates of return.¹²¹

13 RUCO utilized a slightly different water company proxy group than RRUI, with RUCO
14 including American Water Works, Inc., American States Water Company, California Water Service
15 Group, Middlesex Water Company, SJW Corporation and Aqua America. RRUI used the same
16 group, except excluded American Water Works, Inc. and included Connecticut Water Company.¹²²
17 RUCO disagrees that American Water Works Company, Inc. should be excluded, as the company has
18 been followed by *Value Line* since July 2008 after the New Jersey-based provider was spun off from
19 its German parent and became a publicly-traded entity.¹²³ At the time RUCO filed testimony, there
20 were four years of *Value Line* data and under the circumstances, RUCO believes its inclusion in the
21 proxy group is appropriate.¹²⁴ RUCO did not use Connecticut Water Services, Inc. in its analysis
22 because the company used to be followed under *Value Line's* Small and Mid-Cap edition which did
23 not include the same forward-looking data as provided in *Value Line's* Large-Cap Edition. However,
24 RUCO notes that at some point *Value Line* moved Connecticut Water to the Large-Cap edition and it

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26 ¹¹⁹ Ex A-2 Bourassa COC Dir at 42; Ex A-4 Bourassa Rb at 16-17.
¹²⁰ RUCO Closing Brief at 2.
27 ¹²¹ RUCO Closing Brief at 2.
¹²² RUCO Closing Brief at 3.
¹²³ Ex RUCO-1 Rigsby DOD Dir at 21.
28 ¹²⁴ RUCO Closing Brief at 3.

1 is not inappropriate to include Connecticut Water Services in the proxy group, although RUCO did
2 not in this case.¹²⁵

3 RUCO also used a proxy group of nine natural gas local distribution companies (“LDCs”).
4 RUCO argues that using natural gas LDCs as a sample proxy to determine a COE for a water utility
5 is appropriate because LDCs and water and wastewater utilities face similar risks and challenges.¹²⁶
6 RUCO’s water company proxy group had an average beta of 0.69 and its gas company proxy group
7 had an average beta of 0.66.¹²⁷ RUCO states that because its LDC proxy beta is slightly lower, the
8 use of LDCs in the analysis serves to increase RUCO’s recommended COE, not lower it.¹²⁸

9 In response to RRUI’s criticism that RUCO’s COE is lower than an average of long-term
10 projections on book common equity published in *Value Line*, RUCO’s witness Rigsby testified that
11 by definition, the cost of common equity has to be lower than the return on book common equity for
12 the Company to show a profit.¹²⁹ RUCO argues that returns on book equity are not the same as costs
13 of equity capital.¹³⁰ Thus, RUCO argues that comparing actual or projected returns on book equity is
14 not a valid comparison.¹³¹

15 RUCO argued that the Company should have considered all of *Value Line’s* projections for
16 2012 through 2017 rather than relying solely on long-term projections. RUCO asserts that near-term
17 projections have greater reliability and the accepted methodology for calculating growth is the
18 average of all projections rather than just the long-term projections.¹³² RUCO states that if RRUI had
19 considered all of the projections, the Company’s average return on book equity would be 9.69
20 percent; if the Company had included American Water Works in its sample, the 2012 through 2017
21 average return on book equity would be 9.55 percent, and not the 10.3 percent average in the
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¹²⁵ RUCO Closing Brief at 4.

¹²⁶ Tr. at 205 (Rigsby).

¹²⁷ RUCO’s Closing Brief at 4.

¹²⁸ RUCO’s Closing Brief at 5.

¹²⁹ Ex RUCO-2 Rigsby COC Sur at 9-10; citing definition of ROE; Tr. at 155-56.

¹³⁰ RUCO Reply Closing Brief at 4.

¹³¹ RUCO Reply Brief at 4.

¹³² RUCO’s Closing Brief at 6; RUCO Reply Brief at 4. RUCO argue that averaging analysts’ projected returns on book equity is not a substitute for using an appropriate methodology and inputs.

1 Company's Rejoinder.¹³³ The average return on book equity for RUCO's sample, which includes
 2 American Water Works, but not Connecticut Water, is 9.36 percent.

3 In response to claims that RUCO's ROE is low compared to the authorized returns of the
 4 proxy companies, RUCO argues that prior authorized returns based on unknown circumstances
 5 should not be used to determine or test current returns on equity capital.¹³⁴ RUCO states that the
 6 Company is attempting to perform a comparable earnings analysis which has long been criticized for
 7 its circular logic. Furthermore, RUCO asserts that the Company has not submitted any of the reports
 8 on which it relies, nor any way to determine from the information that the Company has provided
 9 when, where, and how the authorized returns were approved. Thus, according to RUCO, the time
 10 period in which the returns were authorized and the circumstances of their approval (e.g. whether
 11 they were based on a settlement agreement, and the reasoning of the public utility commissions in
 12 approving these returns) are unknown.¹³⁵

13 RUCO adjusted its COE estimate downward by 50 basis points to account for RRUI's lower
 14 financial risk resulting from a capital structure consisting of 100 percent equity.¹³⁶ RUCO did not use
 15 the Hamada adjustment methodology to make its downward adjustment.¹³⁷ RUCO argues that the
 16 Company's small firm adjustment is not appropriate on the facts of this case because RRUI is a
 17 subsidiary of APUC, receives all of its capital from its parent, and is allocated APUC expenses
 18 associated with its operation in the Toronto Stock Exchange.¹³⁸ RUCO states that APUC is a
 19 conglomeration of smaller utilities, just like the water companies in the proxy groups, and there is no
 20 factual or legal basis for a small firm adjustment.¹³⁹

21 RUCO also questions Staff's 60 basis point upward adjustment to address economic
 22 uncertainty in the current economy. RUCO does not dispute the existence of economic uncertainty,
 23

24 ¹³³ RUCO's Closing Brief at 6.

¹³⁴ RUCO Reply Brief at 5.

¹³⁵ RUCO Reply Brief at 5.

¹³⁶ RUCO's Closing Brief at 7.

¹³⁷ The Hamada methodology uses a formula to "unlever" the beta of the proxy group and then "relever" the beta to reflect the capital structure and financial risk of the company under analysis. The re-levered beta is then used in the CAPM models and compared to the original CAPM results. The difference is the basis for the financial risk adjustment. Ex A-2 Bourassa COC Dir at 40-41.

¹³⁸ RUCO's Closing Brief at 8; RUCO Reply Brief at 6.

¹³⁹ RUCO's Closing Brief at 8; RUCO Reply Brief at 7.

1 but states that by adopting the upward adjustment of 60 basis points, Staff is insulating a \$3.0 billion
 2 international company from the impact of an economic instability when ratepayers are not insulated
 3 from the same economic uncertainty.¹⁴⁰

4 **C. Staff**

5 Staff also utilized the DCF and CAPM models to arrive at its recommended COE and ROE.
 6 Staff asserts that the Commission has consistently accepted these models and that Staff used
 7 objectively reasonable inputs based on both historical and forecasted economic information. Staff
 8 averaged its DCF results (8.8 percent)¹⁴¹ and did the same for the CAPM results (8.2 percent),¹⁴² and
 9 then took the average of both models (8.5 percent). Staff made two adjustments to the average of both
 10 models, first a 90 basis point downward financial risk adjustment using the Hamada method and a 60
 11 basis point upward “economic assessment adjustment” to account for the current economic
 12 environment.¹⁴³ As a result, Staff recommends a ROE of 8.2 percent.¹⁴⁴

13 Staff utilized two versions of the DCF—the constant growth DCF and the multi-stage growth
 14 DCF. For the constant-growth DCF, Staff calculated the growth factor by averaging the historical
 15 and forecasted earnings per share (“EPS”), dividends per share (“DPS”) and sustainable growth.¹⁴⁵
 16 Staff gave equal weight to historical and projected EPS, DPS and sustainable growth. Staff argues
 17 that in so doing, it used a balanced approach to determining COE.¹⁴⁶ For the multi-stage growth
 18 DCF, Staff analyzed two stages of growth: the first stage has a four-year duration with the growth
 19 rate based on *Value Line’s* projected dividends for the next twelve months and the average dividend
 20 growth rate of 4.8 percent calculated in Staff’s DCF analysis; followed by a second stage of constant
 21 growth using a growth rate based on Gross Domestic Product from 1929 to 2011.¹⁴⁷

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 24 ¹⁴⁰ RUCO Reply Brief at 8.

25 ¹⁴¹ Ex S-2 Cassidy Surr at Sch JAC-3. Staff’s DCF results were 8.0 percent for the Constant Growth model and 9.5
 percent for the Multi-Stage model.

26 ¹⁴² Ex S-2 Cassidy Surr at Sch JAC-3. The Historical Market Risk Premium result was 6.3 percent, and the Current
 Market Risk Premium analysis was 10.0 percent.

27 ¹⁴³ Ex S-1 Cassidy Dir at 2-3.

28 ¹⁴⁴ Staff’s Closing Brief at 4.

¹⁴⁵ Ex S-1 Cassidy Dir at 17-25.

¹⁴⁶ Staff Closing Brief at 6.

¹⁴⁷ Ex S-1 Cassidy Dir at 25-27.

1 Staff criticizes the Company's methodology of disregarding the multi-stage growth model in
2 favor of employing two constant-growth DCF models: Past and Future Growth and Future Growth.
3 Staff states that half of the Past and Future Growth estimate relies on analysts' projections, while the
4 Future Growth model relies entirely on analysts' projections.¹⁴⁸ Staff argues that the Company's use
5 of this midpoint gives analyst projections 75 percent of the weight, while historical data is given only
6 25 percent. Staff asserts that over-reliance on analysts' projections is problematic because those
7 forecasts tend to be biased and overly optimistic.¹⁴⁹ Staff believes that by not giving equal weight to
8 the historic data and projections, the Company inflated the dividend growth rate and skewed the
9 outcome of the DCF analysis. Staff believes that the Company's DCF analysis is also problematic
10 because the Company used only five years of historic data in calculating the dividend growth rate in
11 the Past and Future DCF method. Staff believes that five years is too limited a period to capture a
12 full business cycle and is susceptible to significant variances if there is a single high or low data
13 point. Staff states that choosing the five year period over the ten year period resulted in a higher
14 growth rate which further inflated the COE in the Company's DCF analysis. Staff used ten years of
15 historical data and believes that period is more reasonable because it captures a more robust picture
16 of the economic environment and is information widely used by investors.¹⁵⁰

17 Staff states that its CAPM analysis considers the historical market risk premium and the
18 current market risk premium. The average beta of Staff's proxy group was calculated at 0.71.¹⁵¹ Staff
19 then applied the historical and current U.S. Treasury spot rates in its historical and current market risk
20 CAPM analysis. Staff asserts that in the Company's CAPM analysis, it utilized a forecasted risk-free
21 interest rate in both its historical and current market risk premia, and that because the forecasted rate
22 is higher than the current 30-year long term Treasury yield, it overstates the risk-free interest rate and
23 inflates the COE in the Company's CAPM analysis.¹⁵²

24 Staff argues that the Commission should reject RRUI's "Small Firm Risk Adjustment"
25 because: 1) RRUI is not an unassociated small company, but the subsidiary of a much larger parent

26 ¹⁴⁸ Ex A-2 at 43-44.

27 ¹⁴⁹ Ex S-1 Cassidy COC Dir at 38-40.

¹⁵⁰ Ex S-1 Cassidy COC Dir at 43-44.

¹⁵¹ Ex S-1 Cassidy COC Dir at 33.

28 ¹⁵² Ex S-1 Cassidy COC Dir at 38.

1 corporation; 2) any risk associated with the size of the company is unsystematic or “firm specific
 2 risk” which does not affect investor decisions; and 3) the Commission has appropriately and
 3 continually rejected such an adjustment in the past. Staff argues that as a subsidiary of APUC, a
 4 publicly traded corporation, RRUI is able to avail itself of other resources and capital markets to
 5 which most truly small companies do not have access, and any risk that would be reflected in RRUI’s
 6 beta as a result of size is dissipated by its association with the larger parent company. Staff also
 7 believes that investors are not concerned with “firm specific” risk because investors can eliminate it
 8 by holding diverse portfolios, and any adjustment to COE to account for such risk is unwarranted.

9 **D. Intervenors**

10 Intervenors argue that the allowed return on equity should be no greater than 8.0 percent.
 11 They base their recommendation on the average of Staff’s and RUCO’s estimates of the cost of
 12 equity before their adjustment for “unique business risk” and “Economic Assessment Adjustment.”¹⁵³
 13 They calculate a WACC of 6.07 percent based on a 50/50 debt/equity capital structure, a 4.13 percent
 14 cost of debt, and 8.0 percent. Under Intervenors’ alternative position, which is a capital structure of
 15 20 percent debt and 80 percent equity, they calculate a WACC of 7.226 percent based on an 8.0
 16 percent maximum return on equity and the 4.13 percent cost of debt.¹⁵⁴

17 Intervenors argue that the testimony of Mr. Bourassa, RRUI’s witness on Cost of Capital,
 18 should be given little weight as he is a Certified Public Accountant (“CPA”) and does not hold a
 19 degree in economics or hold a Certified Rate of Return Analyst certificate.¹⁵⁵ They question his
 20 command of the subject, based on responses to questions concerning the Capital Market Line
 21 (“CML”).¹⁵⁶

22 In addition, the Intervenors argue that the authorized return on equity should be historically
 23 low because indications of capital costs are near historic lows.¹⁵⁷ Intervenors note that the Federal

24 ¹⁵³ Intervenors state that prior to adjustment, RUCO’s cost of equity was 7.31 percent and Staff’s was 8.5 percent, which
 25 results in an average of 7.9 percent.

26 ¹⁵⁴ Intervenors’ Combined Opening Brief at 11. They state that the issue of how to adjust the cost of equity downward to
 27 correct for the fact that 80 percent equity is less risky than the industry average of 50 percent lacks clear evidence and
 28 makes the finding of 20/80 debt/equity capital structure more difficult than simply adopting the industry averages for
 capital structure and cost of equity.

¹⁵⁵ Intervenors’ Combined Closing Brief at 3.

¹⁵⁶ Tr. at 69 (Bourassa).

¹⁵⁷ Intervenors’ Combined Opening Brief at 4.

1 Reserve lowered the federal funds target rate to near zero and has expressed an intent to keep the
 2 target federal funds rate at 0.0 percent to 0.25 percent for a considerable time even after its asset
 3 purchase program ends and economic recovery strengthens.¹⁵⁸ In addition, they state the benchmark
 4 U.S. Treasury note yield is at historic lows,¹⁵⁹ and the ten-year Treasuries are lower than in the
 5 past.¹⁶⁰

6 Intervenor assert that the average historical market risk premium over long-term Treasury
 7 securities is 6.6 percent,¹⁶¹ and that the 30-year U. S. Treasury Bond was trading at 3.151 percent on
 8 March 22, 2013.¹⁶² Thus, they argue an estimate of the average stock's return going forward is about
 9 9.8 percent (6.6% + 3.151%), but based on Mr. Bourassa's beta of 0.72, RRUI should have a lower
 10 return than the average stock. In addition, Intervenor argue that RRUI's COE should be reduced to
 11 account for its capital structure. They state:

12 RRUI merits a 90 basis point reduction to an average 50/50 water utility to
 13 correct if one uses the 100 % equity capitalization. Therefore, it would be
 14 reasonable to award a 4.8% utility risk premium (0.72 X 6.6%) plus
 15 3.151% current long-term US Treasury yield for a 7.9% cost of equity,
 reduced by 80 basis points to account for 100% equity . . . or a 7.1% return
 on equity if relying on Mr. Bourassa's testimony.¹⁶³

16 Intervenor also argue that the authorized return on equity should be low because stock
 17 market volatility, as measured by the Volatility Index ("VIX") is at historic lows since at least
 18 January 2, 2008.¹⁶⁴ They state that relating the VIX to the CML, one concludes that the expected
 19 return on market portfolio would also be low.

20 The Intervenor also dispute RRUI's claim that Contributions in Aid of Construction
 21 ("CIAC") and Advances in Aid of Construction ("AIAC") in RRUI's capital structure raises the
 22 Company's risk, because CIAC does not have fixed principal or interest payments and AIAC is
 23 refunded contingent on the developer reaching certain goals, and might never be refunded.¹⁶⁵ They
 24

25 ¹⁵⁸ Tr. at 60-61 (Bourassa); Ex SCVUSD-2 at 2.

¹⁵⁹ Ex SCVUSD-3.

26 ¹⁶⁰ Tr. at 64 (Bourassa).

¹⁶¹ Ex A-2 Bourassa COC Dir at 36.

27 ¹⁶² Ex SCVUSD-8.

¹⁶³ Intervenor's Combined Opening Brief at 4, citations omitted.

¹⁶⁴ Intervenor's Combined Opening Brief at 4-5.

28 ¹⁶⁵ Ex A-2 Bourassa COC Dir at 22; Tr. at 75-76.

1 also assert that Mr. Bourassa over-estimated the dividend yield in his DCF and therefore over-
 2 estimated his DCF calculations. They claim that when he calculated his current dividend yield, Mr.
 3 Bourassa utilized the dividend yield for the next year instead of the current yield which biased his
 4 calculations upwards. The Intervenors also criticize Mr. Bourassa's reliance on analyst forecasts of
 5 earnings growth instead of forecasts of dividend growth.¹⁶⁶ They criticize Mr. Bourassa's CAPM for
 6 using data that is more than a year old to calculate the "current" market risk premium. They argue
 7 that his calculations are not current and merit no weight.¹⁶⁷

8 Intervenors argue that for his CAPM analyses, Mr. Bourassa relied on forecasts of the long-
 9 term US Treasury rate that were higher than the actual market-based 30-year U.S. Treasury rates at
 10 the time of the hearing.¹⁶⁸ They state that the interest rates utilized by Mr. Bourassa were made by
 11 forecasting services, and argue that observable market rates should be relied on in performing a
 12 CAPM cost of equity analysis.

13 Intervenors argue that there is a lack of evidence that would support applying a small
 14 company risk premium.¹⁶⁹ They believe that the Company's recommended small company risk
 15 premium should not be given any weight, and they argue that the appearance that small firms seem
 16 inherently riskier than larger companies is really a "January effect" that affects all size groups.

17 Intervenors also argue against the "Economic Assessment Adjustment" of 60 basis points
 18 used by Staff.¹⁷⁰ They claim that the adjustment is not based on any treatise or peer-reviewed journal
 19 and argue that no adjustment is warranted. They state that under the efficient market hypothesis,
 20 stock prices already reflect expectations of uncertainty and therefore the uncertain status of the
 21 economy is already factored into market data.

22 Intervenors argue that the record supports employing a capital structure of 50 percent debt and
 23 50 percent equity.¹⁷¹ They note that the capital structure of the proxy group used by the Company
 24 was approximately 50/50 debt/equity (RUCO's proxy group contained 45.7 percent equity, and

25 ¹⁶⁶ Intervenors' Combined Opening Brief at 5.

26 ¹⁶⁷ Intervenors' Combined Opening Brief at 6.

27 ¹⁶⁸ Intervenors' Combined Opening Brief at 7. Intervenors state that Mr. Bourassa used rates of 3.8 percent and 3.7 percent, but that the 30-year US Treasury rate was 3.151 percent at the time of the hearing. Ex SCVUSD-8.

28 ¹⁶⁹ Intervenors' Combined Opening Brief at 6-7.

¹⁷⁰ Intervenors' Combined Opening Brief at 8.

¹⁷¹ Intervenors' Combined Opening Brief at 8-9.

1 Staff's proxy group consisted of 48.8 percent equity) and argue that a capital structure of 100 percent
 2 equity is out of the norm and inefficient. They urge the Commission to adopt the industry norm of
 3 approximately 50 percent equity and apply an appropriately-calculated proxy group average cost of
 4 equity. They believe such approach is the most transparent way to coordinate the cost of equity and
 5 capital structure and minimizes judgment and miscalculations from the Hamada adjustment. They
 6 assert that the Commission should utilize a cost of debt of 4.13 percent which was RUCO's estimated
 7 cost of debt based on the current yield on a Baa/BBB-rated utility bond. They assert that RUCO's
 8 estimate takes account of current capital market conditions, and argue that RRUI's initially proposed
 9 5.7 percent cost of debt was derived from the rate used in the last rate case and has no relationship to
 10 current capital market conditions.

11 **E. Responses to Intervenors' Cost of Capital Recommendations**¹⁷²

12 RRUI asserts that Mr. Bourassa is a qualified cost of capital witness with a B.S. in
 13 Chemistry/Accounting, an MBA with an emphasis in Finance, and a CPA.¹⁷³ RRUI states that Mr.
 14 Bourassa has testified before the Commission on cost of capital in approximately three dozen cases
 15 over ten years and the Commission has never questioned his qualifications. RRUI also notes that Mr.
 16 Bourassa is as qualified as either of the other two cost of capital witnesses in this case.¹⁷⁴

17 RRUI argues that generalizations and conclusions about the economy are not substantial
 18 evidence.¹⁷⁵ RRUI does not dispute that interest rates are at historic lows or that the VIX is at its
 19 lowest point since 2008, but asserts that the test of whether the authorized return is appropriate is not
 20 whether interest rates are at historic lows, but whether the cost of capital meets the comparable
 21 earnings test set forth in *Hope* and *Bluefield*.¹⁷⁶ RRUI states that the one-year average total return for
 22 the sample companies is 17.15 percent and the recent three-year average of the sample companies is
 23

24
 25 ¹⁷² Because Intervenors did not present a cost of capital witness, the first time the other parties were aware of their
 position on Cost of Capital was in the Closing Brief.

26 ¹⁷³ Ex A-9 Bourassa COC Dir at 1-9; Tr at 112-113 (Bourassa).

27 ¹⁷⁴ RRUI Reply Opening Brief at 11-12.

28 ¹⁷⁵ Substantial evidence is defined as "more than a scintilla but less than preponderance, "and consists of such relevant
 evidence as a reasonable person would accept as adequate to support a conclusion." *Mareno v. Apfel*, 1999 U.S. Dist.
 LEXIS 8575.

¹⁷⁶ RRUI Reply Closing Brief at 13.

1 10.14 percent, and that there is nothing about the general economy that justifies dramatically lower
2 returns for RRUI.¹⁷⁷

3 RRUI asserts that AIAC and CIAC are indeed two of the many factors that should be
4 considered in assessing risks faced by the Company, and that having AIAC and CIAC in a capital
5 structure adds to risk – AIAC because it is an obligation owed to a third party and is similar to debt,
6 and CIAC because plant funded by contributions still has to be operated and repaired at the
7 Company’s expense and then replaced with debt or equity capital.¹⁷⁸ RRUI asserts that Intervenors
8 can “quibble about how much risk exists, but they can point to no evidence in the record to the
9 contrary and any suggestion that AIAC and CIAC create no risk is unsupported and simply not
10 credible.”¹⁷⁹

11 RRUI argues that the Intervenors’ reliance on the “January Effect” as a basis to disregard
12 consideration of size in assessing risk is not well-placed.¹⁸⁰ RRUI asserts that any claim that RRUI’s
13 small size relative to the proxy group does not matter at all, is not credible. RRUI also claims that
14 Intervenors provide no basis for their claims that Mr. Bourassa overstated his DCF or CAPM
15 analyses. RRUI assert that the arguments made by Intervenors lack substantial evidence, and are
16 merely unsupported and mistaken opinions of counsel.¹⁸¹

17 RRUI also argues that Intervenors’ recommended capital structures (either 50/50 debt/equity
18 or 20/80 debt/equity) are not supported by substantial evidence and should be rejected.¹⁸² RRUI notes
19 that Staff and RUCO agree that the Company’s actual capital structure should be used. In addition,
20 RRUI asserts that in making their recommendations on cost of capital, Intervenors do not account for
21 the additional risk that would come with the imputation of debt into the capital structure. RRUI
22 acknowledges that its parent did not infuse debt into the Company, but also states that there is no
23 evidence that it did so with the intent to harm customers or unnecessarily increase the cost of service,
24 and moreover, it “tried to have its rates set exactly as if it did infuse the debt.”¹⁸³ RRUI states that

25 ¹⁷⁷ *Value Line* Investment Survey January 18, 2013; RRUI Reply Closing Brief at 14.

26 ¹⁷⁸ Ex A-2 Bourassa COC Dir at 22; Tr. at 76 (Bourassa); RRUI Reply Closing Brief at 14.

27 ¹⁷⁹ RRUI Reply Closing Brief at 14.

28 ¹⁸⁰ RRUI Reply Closing Brief at 15.

¹⁸¹ RRUI Reply Closing Brief at 17.

¹⁸² RRUI Reply Closing Brief at 17-18.

¹⁸³ RRUI Reply Closing Brief at 19.

1 with the parties' various risk adjustments to determine the ROE, the difference between the final cost
2 of capital with or without the 20 percent debt is minimal.¹⁸⁴

3 RRUI argues that an ROE of 8 percent is unreasonable and would not satisfy the comparable
4 earnings test. The Company asserts that Intervenors provided no witness to support their
5 recommended returns or the calculations in their brief, and their recommended ROE does not
6 reasonably compare to comparable utilities.¹⁸⁵

7 Staff argues that Intervenors' recommendation that the Commission should utilize a 50/50
8 debt/equity capital structure should be rejected because it is not based on evidence and ignores the
9 actual capital structure of RRUI.¹⁸⁶ Staff asserts that there is no evidence that a 50 percent
10 debt/equity structure is more appropriate, or more transparent or minimizes judgment and
11 miscalculation from the Hamada adjustment, than the capital structure recommended by every other
12 party to the proceeding.¹⁸⁷

13 In addition, Staff argues that its economic assessment adjustment of 60 basis points is
14 reasonable and appropriate.¹⁸⁸ Staff states that it agrees that its market-based cost of equity estimation
15 already reflects expectations of uncertainty at the time the analysis is conducted, but that "the
16 ratemaking process is less agile than market responses and the cost of equity authorized in this case
17 will remain in place until the Company's next rate case."¹⁸⁹ Staff asserts that its Economic
18 Assessment Adjustment is appropriate:

19 because it considers the disconnect between the responsiveness of the
20 market to changes in the cost of equity and the responsiveness of the
21 ratemaking process in recognizing these changes at a time when
22 extraordinary macro-economic conditions (e.g., countries with large GDPs
23 teetering on the edge of defaulting on their debt, massive debt by the
24 United States, multi-year historical and projected spending deficits in the
United States with no consensus for resolution, long-term high
unemployment in the United States and the European Union, simultaneous
new record high stock prices and near record low interest rates) exist.¹⁹⁰

25 ¹⁸⁴ Tr. at 184-185 (Rigsby); Tr. at 106-107 (Bourassa).

26 ¹⁸⁵ RRUI Reply Brief at 19.

27 ¹⁸⁶ Staff Reply Brief at 2-3.

28 ¹⁸⁷ Staff Reply Brief at 3.

¹⁸⁸ Staff Reply Brief at 3-4.

¹⁸⁹ Staff Reply Brief at 3.

¹⁹⁰ Staff Reply Brief at 4.

1 **F. Analysis and Conclusion**

2 **1. Capital Structure**

3 In RRUI's last rate case, the Commission found that a capital structure consisting of 20
4 percent debt and 80 percent equity was reasonable.¹⁹¹ At that time, the Commission utilized a cost of
5 debt of 5.7 percent and a cost of equity of 9.5 percent resulting in a WACC of 8.74 percent. The
6 Commission considered using a pro forma capital structure containing 20 percent debt and 80 percent
7 equity in the rate case prior to that, but ultimately decided not to because of an operating loss for the
8 Wastewater Division.¹⁹²

9 When it filed the Rate Application, RRUI employed a pro forma capital structure consisting
10 of 20 percent debt and 80 percent equity.¹⁹³ In direct testimony, RUCO also utilized a 20/80 pro
11 forma capital structure, but Staff employed the actual capital structure and adjusted the cost of equity
12 to reflect less financial risk. In rebuttal testimony, RRUI continued to utilize a 20/80 debt/equity
13 capital structure. In surrebuttal testimony RUCO changed its recommendation, and at that point, both
14 RUCO and Staff were advocating using the Company's actual 100 percent capital structure.¹⁹⁴ In
15 rejoinder testimony, RRUI adopted Staff's and RUCO's recommended 100 equity capital structure in
16 order to eliminate issues.¹⁹⁵

17 At this time, debt financing rates are at, or near, historically low levels. By continuing to
18 utilize a 100 percent equity capital structure, the Company is not taking advantage of a low cost
19 source of capital. The Company initially imputed the cost of debt as if it had infused the debt, but did
20 not offer an explanation for why it did not inject the debt. When it approved RRUI's last rate case,
21 the Commission expected that the debt infusion would be made, and that three years later, RRUI
22 would have debt as part of its capital structure. The Company initially recognized this but backed-off
23 that proposal to narrow issues. Narrowing issues is encouraged when the resolution of the issue is in
24

25 _____

26 ¹⁹¹ Decision No. 72059 at 33.

27 ¹⁹² Decision No. 67279 (October 5, 2004) (Prior to Liberty Water ownership) the rate of return adopted in 2004 was 8.7 percent.

28 ¹⁹³ Ex A-2 Bourassa COC Dir at 2.

¹⁹⁴ Ex RUCO-2 Rigsby COC Surr at 8; Ex S-2 Cassidy Surr at 1.

¹⁹⁵ Ex A-6 Bourassa COC Rj at 3.

1 the public interest. In this case, we believe the Company's and RUCO's initial positions on capital
2 structure should have prevailed as issues were narrowed.

3 For this Company, which has a parent company with access to the capital markets, at this
4 point in time, a 100 percent capital structure is not reasonably balanced, and unnecessarily increases
5 the cost of service for ratepayers. We believe that a modest level of debt in RRUI's capital structure
6 is in the public interest, will not unduly increase financial risk, and will better balance the interests of
7 the shareholders and ratepayers. Consequently, we continue to authorize a pro forma capital structure
8 consisting of 20 percent debt and 80 percent equity. The parties claim that by adjusting the cost of
9 equity to reflect the absence of debt in the capital structure, they account for the equity rich capital
10 structure. However, although this adjustment appropriately reduces the cost of equity, it does not
11 provide the benefits of including a modest degree of lower-cost debt in the capital structure.

12 **2. Cost of Debt**

13 In its direct testimony RRUI utilized 5.7 percent as the cost of debt because this was the rate
14 utilized in the last rate case.¹⁹⁶ However, RRUI did not actually infuse debt into RRUI at 5.7 percent,
15 or at any rate. In rebuttal, RRUI testified that Liberty Utilities' current bond rating is BBB-, and that
16 the 5.7 percent cost of debt utilized in its calculations comports with a 2010 Liberty Utilities credit
17 facility that bears a 5.6 percent interest rate.¹⁹⁷ RRUI states that with the financing costs included, the
18 effective interest rate is 5.7 percent.

19 In its direct case, RUCO proposed utilizing a cost of debt of 4.13 percent which was the
20 current yield on a Baa/BBB rated utility bond.¹⁹⁸ Although RUCO no longer recommends utilizing a
21 pro forma capital structure, Intervenors currently recommend utilizing 4.13 percent as the cost of
22 debt.¹⁹⁹

23 Liberty Utilities' credit rating appears to be a grade below that utilized by RUCO and
24 Intervenors. We find that a 5.7 percent cost of debt is reasonable as it is based on the cost of a 2010
25

26
27 ¹⁹⁶ Ex A-2 Bourassa COC Dir at 2.

¹⁹⁷ Ex A-4 Bourassa COC Reb at 19.

¹⁹⁸ Ex RUCO-1 Rigsby COC Dir at 56.

28 ¹⁹⁹ Intervenors' Combined Closing Brief at 9.

1 credit facility obtained by Liberty Utilities. There is no evidence that APUC, Liberty Water or RRUI
2 could borrow at the 4.13 percent rate suggested by Intervenors.

3 3. Cost of Equity

4 All of the parties presenting testimony on the cost of equity use the same methodology of
5 using a proxy group of publicly traded utilities and the CAPM and DCF models to estimate RRUI's
6 COE. They presented evidence for the COE that ranged from 8.5 percent to 9.8 percent before
7 making adjustments for various alleged risks. Their ultimate recommended COEs ranged from 8.2
8 percent to 9.5 percent, after adjusting for financial risk, small firm size and/or economic conditions.
9 Although they all use versions of the DCF and CAPM models, they used different inputs for time
10 frames, risk-free rates, and growth factors. RRUI was criticized for relying too heavily on analyst
11 forecasts and making an upward adjustment for RRUI's small size relative to the proxy group.
12 RUCO's choice of proxy companies was criticized, as was Staff's "economic assessment
13 adjustment," because under the efficient market theory that underpins the DCF and CAPM, rates
14 already reflect economic conditions.²⁰⁰

15 As we noted in the prior RRUI rate case, The *Hope* and *Bluefield* decisions provide that the
16 Commission must determine a return that is equivalent to an investment with similar risk made at
17 generally the same time, and should be sufficient under efficient management to enable the company
18 to discharge its duties. The *Bluefield* court also held, "[w]hat annual rate will constitute just
19 compensation depends on many circumstances and must be determined by the exercise of a fair and
20 enlightened judgment, having regard to all relevant facts."²⁰¹ Based on all of the evidence presented,
21 including the impact on ratepayers, we find that a COE of 9.2 percent is appropriate, will provide the
22 Company with a reasonable and appropriate return on its investment, and will result in just and
23 reasonable rates.

24 _____
25 ²⁰⁰ Relying on the other parties' witnesses, Intervenors argue for a cost of equity of no more than 8.0 percent based on a
26 pro forma capital structure. First, we reject Intervenors assertion that Mr. Bourassa is not qualified to testify in the area of
27 cost of capital. In this and many other rate cases, Mr. Bourassa has demonstrated knowledge of the subject matter; and
28 even if the Commission has not always adopted his recommendations, we find that he is well-qualified to make them.
Second, we exclude Intervenors' suggested COE of either 7.1 or 8.0 percent from the ranges of estimated COEs because
they did not offer a witness to support their calculations, and their assertions have not been tested by cross examination
and cannot be relied upon.

²⁰¹ *Bluefield*, 262 U.S. at 692.

1 **4. Weighted Average Cost of Capital and Authorized Return**

2 Using a pro forma capital structure of 20 percent debt and 80 percent equity, and applying a
3 cost of debt of 5.7 percent, and cost of equity of 9.2 percent, we reach a WACC of 8.5 percent.
4 Accordingly, we find that a fair value rate of return of 8.5 percent will result in just and reasonable
5 rates.

6 **VIII. Revenue Requirement**

7 Based on the discussion herein, revenue increases for RRUI's Water and Wastewater
8 Divisions are authorized as follows:

9 **A. Water Division**

10 Based on our findings herein, we determine the gross revenue for RRUI's Water Division
11 should increase by \$335,737 or 11.72 percent, from \$2,864,823 in the test year, to \$3,200,560.

12	Fair Value Rate Base	\$7,731,209
13	Adjusted Test Year Operating Income ²⁰²	\$454,769
14	Required Fair Value Rate of Return	8.5%
15	Required Operating Income	\$657,153
16	Operating Income Deficiency	\$202,384
17	Gross Revenue Conversion Factor	1.6589
18	Gross Revenue Increase	\$335,737
19	Adjusted Test Year Revenue	\$2,864,823
20	Authorized Revenue Requirement	\$3,200,560
21	Revenue Increase	11.72%

22 **B. Wastewater Division**

23 Based on our findings herein, we determine that gross revenue for RRUI's Wastewater
24 Division should increase by \$78,847 or 5.62 percent, from \$1,402,843 to \$1,481,690.

25	Fair Value Rate Base	\$4,790,738
26	Adjusted Test Year Operating Income	\$359,684

27 _____
28 ²⁰² Using a pro forma capital structure affected adjusted test year income as presented by the parties because of the interest synchronization associated with the imputed debt.

1	Required Fair Value Rate of Return	8.5%
2	Required Operating Income	\$407,213
3	Operating Income Deficiency	\$47,529
4	Gross Revenue Conversion Factor	1.6589
5	Gross Revenue Increase	\$78,847
6	Adjusted Test Year Revenue	\$1,402,843
7	Authorized Revenue Requirement	\$1,481,690
8	Revenue Increase (%)	5.62%

9 **IX. Rate Design**

10 RRUI, RUCO and Staff agreed to utilize Staff’s recommended rate designs. Intervenors did
11 not provide a rate design recommendation, other than to suggest applying any increase evenly across
12 rate classes

13 **A. Water Division**

14 RRUI’s current rate design for its Water Division is based on monthly minimum charges that
15 increase by meter size. There are five meter sizes serving residential customers, seven meter sizes
16 serving commercial customers, two serving industrial customers and two serving multi-family
17 customers. All customers in the 5/8 x 3/4-inch rate class have a three-tiered rate design, while all other
18 rate classes with meters greater than the 5/8 x 3/4-inch have a two-tiered rate design. In addition, there
19 are three fire sprinkler rates with a fixed monthly charge only.

20 Staff’s proposed rate design maintains the current basic design and attempts to keep the
21 percentage of total revenues derived from each class close to current percentages. Subsequent to the
22 hearing, RRUI, RUCO and Staff also agreed to provide the School District with a 5 percent
23 discount.²⁰³

24 Using the parties’ recommended rate design, and the revenue requirement we authorized
25 herein, we approve the following rates and charges for RRUI’s Water Division:

26 ...

27

28 ²⁰³ RRUI Final Schedules at Exhibits 5 and 6.

	<u>Current Rates</u>	<u>Approved Rates⁽¹⁾</u>
1		
2	Monthly Usage Charge	
2	Meter Size (All Classes)	
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Morningstar Ranch Community Association - 6
inch²⁰⁴

**Commodity Charge (per 1,000 gallons) all classes
(less 15% for low income customers as applicable)**

12	5/8 x 3/4 inch meter		
13	First 3,000 gallons	\$1.59	\$1.49
13	3,001-9,000 gallons	2.92	2.98
14	Over 9,000 gallons	3.64	3.49
15	3/4 inch meter		
15	First 6,000 gallons	2.92	NA
16	Over 6,000 gallons	3.64	NA
16	First 4,500 gallons	NA	2.98
17	Over 4,500 gallons	NA	3.49
18	1 inch meter		
18	First 15,000 gallons	2.92	NA
19	Over 15,000 gallons	3.64	NA
19	First 22,500 gallons	NA	2.98
20	Over 22,500 gallons	NA	3.49
21	1 1/2 inch meter		
21	First 20,000 gallons	2.92	NA
22	Over 20,000 gallons	3.64	NA
22	First 45,000 gallons	NA	2.98
23	Over 45,000 gallons	NA	3.49
24	2 inch meter		
24	First 57,000 gallons	2.92	NA
25	Over 57,000 gallons	3.64	NA
25	First 72,000 gallons	NA	2.98
26	Over 72,000 gallons	NA	3.49
27	3 inch meter		

²⁰⁴ Morningstar Ranch is a development that is not within RRUI's certificated area.

1	First 57,000 gallons	2.92	NA
	Over 57,000 gallons	3.64	NA
2	First 144,000 gallons	NA	2.98
	Over 144,000 gallons	NA	3.49
3	4 inch meter		
4	First 57,000 gallons	2.92	NA
	Over 57,000 gallons	3.64	NA
5	First 225,000 gallons	NA	2.98
	Over 225,000 gallons	NA	3.49
6	6 inch meter		
7	First 125,000 gallons	2.92	NA
	Over 125,000 gallons	3.64	NA
8	First 450,000 gallons	NA	2.98
	Over 450,000 gallons	NA	3.49
9	8 inch meter		
10	First 125,000 gallons	2.92	NA
	Over 125,000 gallons	3.64	NA
11	First 720,000 gallons	NA	2.98
	Over 720,000 gallons	NA	3.49
12	10 inch meter		
13	First 125,000 gallons	2.92	NA
	Over 125,000 gallons	3.64	NA
14	First 1,025,000 gallons	NA	2.98
	Over 1,025,000 gallons	NA	3.49
15	12 inch meter		
16	First 125,000 gallons	2.92	NA
	Over 125,000 gallons	3.64	NA
17	First 1,025,000 gallons	NA	2.98
	Over 1,025,000 gallons	NA	3.49
18	Morningstar Ranch Community Association	N/A	4.79
19	Fire Lines:		
20	Up to 8 inches	Per Rule ****	Per Rule ****
	10 inches	Per Rule****	Per Rule****
21	12 inches	Per Rule ****	Per Rule ****
22	Other Service Charges:		
	Establishment	\$10.00	\$15.00
	Establishment (After Hours)	25.00	25.00
23	Reconnection (Delinquent)	15.00	15.00
	Reconnection (Delinquent) (After Hours)	25.00	NT
24	Meter Test (If correct)	15.00	15.00
	Deposit	*	*
25	Deposit Interest	**	**
	Re-establishment (within 12 months)	***	***
26	NSF Check	15.00	15.00
	Late Payment Penalty	1.5% per mo.	1.5% per mo.
27	Deferred Payment	1.5% per mo.	1.5% per mo.
	Moving Meter at Customer Request	At Cost	At Cost
28	Service Calls – per hour/after hours (a)	40.00	NT

After hours service calls NT 50.00

(1) A 5 percent discount is applicable to entities whose primary function is education.

*Per Commission Rule A.A.C. R14-2-403 (B)

**Per Commission Rule A.A.C. R14-2-403(B)

***Per Commission Rule A.A.C. R14-2-403(D) – months off the system times the monthly minimum

****1 percent of monthly minimum for a comparable size meter, but no less than that \$5.00 per month. The service charge for fire sprinklers is only applicable for service line separate and distinct from the primary water service line.

(a) No charge for service calls during normal working hours.

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use and franchise tax, per commission Rules A.A.C. R14-2-408(5).

**Service and Meter Installation Charges
(Refundable pursuant to A.A.C. R14-2-405)**

Service Size	Current Rates			Authorized Rates		
	Service Line	Meter	Total	Service Line	Meter	Total
5/8 inch	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost
¾ inch	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost
1 inch	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost
1 ½ inch	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost
2 inch	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost
3 inch	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost
4 inch	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost
6 inch	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost
8 inch	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost
10 inch	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost
12 inch	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost

The rates approved herein would increase the monthly bill for an average 5/8 x ¾ inch meter residential customer with usage of 9,061 gallons by \$4.53, or 13.5 percent, from \$33.49 to \$38.02.

B. Wastewater Division

RRUI’s current wastewater rate design is based largely on flat monthly rates. Single-family residential customers pay a flat monthly rate based on the size of their water meter. In addition to paying the same monthly customer charges as single-family residential customers, commercial and multifamily residential customers also pay a commodity charge that is based on water use that exceeds 7,000 gallons per month. The proposed rates reflect the same basic design as the current rates, but include a 5 percent discount for School District.

...

1 Using the parties' recommended rate design, and the revenue requirement established above,
 2 we approve the following rates and charges for RRUI's Wastewater Division:

3	<u>Monthly Usage Charge</u>	<u>Current Rates</u>	<u>Approved Rates⁽¹⁾</u>
4	Meter Size (All Classes)		
5	5/8 x 3/4 inch	\$45.88	\$49.00
6	5/8 x 3/4 inch (low income)	39.00	41.65
7	3/4 inch	52.88	56.50
8	3/4 inch (low income)	44.95	48.03
9	1 inch	64.64	69.10
10	1 inch (low income)	54.94	58.74
11	1 1/2 inch	95.44	102.00
12	2 inch	132.38	141.50
13	3 inch	230.62	246.50
14	4 inch	341.83	365.40
15	6 inch	649.58	694.40
16	8 inch	944.45	1,057.78
17	10 inch	1,415.24	1,585.07
18	12 inch	2,012.57	2,254.08
19	Commodity Charge – per 1,000 gallons		
20	<u>Commercial and Multi-Tenant Only</u>		
21	0 gallons to 7,000 gallons	--	--
22	Over 7,000 gallons	\$4.67	\$5.00
23	<u>Other Service Charges</u>		
24	Establishment	\$15.00	\$15.00
25	Establishment (After Hours)	25.00	NT
26	Reconnection (Delinquent)	15.00	15.00
27	Reconnection (Delinquent) After Hours	25.00	NT
28	Deposit	*	*
29	Deposit Interest	**	**
30	Re-establishment (within 12 months)	***	***
31	NSF Check	25.00	25.00
32	Late Payment Penalty	1.5% per mo.	1.5 % per mo.
33	Deferred Payment	1.5% per mo.	1.5% per mo.
34	Service Calls – per hour/after hours(a)	40.00	NT
35	After Hours Service Charge	NT	50.00
36	<u>Service Line Installation Charges</u>		
37	Service Line Size		
38	4 inch	At Cost	At Cost
39	6 inch	At Cost	At Cost
40	8 inch	At Cost	At Cost
41	10 inch	At Cost	At Cost
42	12 inch	At Cost	At Cost

(1) A 5 percent discount is applicable to entities whose primary function is education.

*Per Commission Rule A.A.C. R14-2-603(B)

**Per Commission Rule A.A.C. R14-2-603(B)

*** Per Commission Rule A.A.C. R14-2-603(D) – Months off system times the monthly minimum.

(a) No charge for service calls during normal working hours.

28 ...

1 Under the authorized rates, the monthly residential wastewater bill would increase \$3.12, or
2 6.8 percent, from \$45.88 to \$49.00.

3 **X. Other Issues**

4 Staff’s investigation of RRUI led to the following findings and conclusions:²⁰⁵

- 5 1. The Arizona Department of Environmental Quality (“ADEQ”) regulates RRUI’s water
6 system under ADEQ Public Water System (“PWS”) No. 12-011. Based on compliance
7 information submitted by the Company, the system has no deficiencies and ADEQ has
8 determined that the system is currently delivering water that meets water quality standards
9 required by A.A.C. Title 18, Chapter 4 (ADEQ report dated November 6, 2012);
- 10 2. RRUI is located within the Santa Cruz Active Management Area (“AMA”) and is subject
11 to its AMA reporting and conservation requirements. Staff received an Arizona
12 Department of Water Resources (“ADWR”) compliance status report on November 6,
13 2012, which indicated that RRUI is currently in compliance with ADWR requirements
14 governing water providers and/or community water systems;
- 15 3. Staff concluded that the Company has adequate water production and storage capacity to
16 serve the existing customer base and reasonable growth;
- 17 4. The Commission’s Utilities Division Compliance Section shows no delinquent
18 compliance items for RRUI;
- 19 5. RRUI has approved Curtailment Plan and Backflow Prevention Tariffs on file with the
20 Commission;
- 21 6. RRUI has ten approved Best Management Practice (“BMP”) tariffs on file with the
22 Commission;
- 23 7. The Company reported 807,817,000 gallons pumped, 678,845,000 gallons sold and
24 48,810,000 gallons used for flushing lines, construction, backwashing and fire
25 suppression, resulting in a water loss of 9.92 percent for the test year;

26 ...

28 ²⁰⁵ Ex S-5 Liu Dir at 3-7.

- 1 8. ADEQ regulates the RRUI wastewater treatment plants under Permit No. 14919 and
 2 52015, and pursuant to the November 10, 2012 Compliance Status Reports issued by
 3 ADEQ, the systems are in compliance with ADEQ requirements; and
 4 9. RRUI has adequate wastewater treatment capacity to serve the existing customer base and
 5 reasonable growth for both wastewater systems.

6 In addition to rates and charges, Staff recommends the following:

- 7 1. RRUI file documentation showing specific procedures and steps taken to ensure that there
 8 is an accurate accounting of the amount of water actually used for "Authorized Use"
 9 purposes, and that the documentation should be filed as a compliance item with Docket
 10 Control within 60 days of the effective date of the Commission Decision in this matter;
 11 2. If the water used by "Authorized Use" in one month is more than 5,000,000 gallons the
 12 Company should explain in detail the reason(s) for this use in its annual water loss
 13 compliance reporting per Decision No. 72059;²⁰⁶
 14 3. The Company continue to record and monitor monthly water losses and repair any leak as
 15 soon as it is discovered; and
 16 4. RRUI be required to provide separate wastewater descriptions for its major wastewater
 17 system (wastewater flows to the NWWTP) and small wastewater system (the aerobic
 18 stabilization pond) in future Commission Annual Reports, beginning with the 2013
 19 Annual Report filed in 2014.

20 RRUI has agreed to Staff's recommendations. We find that Staff's recommendations
 21 concerning plant operations and reporting are reasonable and adopt them.

22 During the hearing, the issue of the number of Spanish speaking residents in RRUI's service
 23 territory was discussed.²⁰⁷ In addition, the Company reported that despite claims that the service
 24 territory was located in an economically depressed area, there is a low "take rate" for the low income
 25 tariff that was approved in the last rate case.²⁰⁸ The Company appeared committed to finding

26 _____
 27 ²⁰⁶ In the last rate case, the Commission ordered RRUI to file an annual water loss report within 90 days of the end of
 each calendar year.

28 ²⁰⁷ Tr. at 338-344 (Sorenson).

²⁰⁸ Tr. at 325 (Sorensen).

1 effective ways to communicate with its Spanish-speaking customers. The Company already employs
2 Spanish speaking customer service representatives, but Mr. Sorensen suggested there may be other
3 ways to reach out to Spanish-speaking customers, such as making better use of its newsletter.²⁰⁹ In
4 this period before the next rate case, the Company, with assistance from Staff and RUCO, should
5 attempt to devise an efficient and cost-effective means for conveying information about its low
6 income tariff as well as any future proposed rate increases to its bilingual and Spanish-speaking
7 community. This may be (but is not limited to) by providing information in Spanish on the website,
8 making use of its newsletter or community forums and/or in bill inserts about who qualifies and how
9 to apply for its low income tariff and how to receive complete translated public notices in writing.

10 * * * * *

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

13 **FINDINGS OF FACT**

14 1. RRUI provides water and wastewater service to an area of Santa Cruz County,
15 Arizona. In the test year ended February 29, 2012, the Company provided water-only service to
16 approximately 6,751 connections, and combined water and wastewater service to 2,207 connections.

17 2. RRUI is a subsidiary of Liberty Utilities is a subsidiary of APUC, a publicly-traded
18 corporation on the Toronto Stock Exchange.

19 3. RRUI's current rates were set in Decision No.72059 (January 6, 2011).

20 4. On May 31, 2012, RRUI filed its Rate Application.

21 5. On June 28, 2012, RRUI filed an Amendment to its Application.

22 6. On July 2, 2012, Staff notified the Company that its Rate Application was sufficient
23 under the guidelines outlined in A.A.C. R14-2-103, and classified the utility as Class B.

24 7. On July 5, 2012, Staff filed a Proposed Schedule and Request for Procedural Order.

25 8. On July 6, 2012, RUCO filed an Application to Intervene.

26 ...

27
28 ²⁰⁹ Tr. at 326 (Sorensen).

1 9. By Procedural Order dated July 13, 2012, RUCO was granted intervention, the hearing
2 was set for March 26, 2013, and other procedural deadlines were established, including dates to file
3 pre-filed written testimony and for intervention.

4 10. On August 13, 2012, RRUI filed a Request to Modify Procedural Schedule by moving
5 the start of the hearing one day later to March 27, 2013. By Procedural Order dated August 17, 2012,
6 the request was granted.

7 11. On October 5, 2012, RRUI filed an Affidavit of Certification of Mailing and
8 Publication indicating that notice of the hearing was published in the *Nogales International* on
9 September 21, 2012, and mailed to customers on September 7, 2012, September 12, 2012, and
10 September 24, 2012.

11 12. On December 13, 2012, the County filed a Request to Intervene, which was granted on
12 December 28, 2012.

13 13. On December 31, 2012, Staff and RUCO filed direct testimony related to rate base and
14 revenue requirement.

15 14. On January 7, 2013, Staff and RUCO filed direct testimony related to cost of capital
16 and rate design.

17 15. On January 25, 2013, the School District, a customer of RRUI, filed a Motion to
18 Intervene.

19 16. On January 28, 2013, RRUI filed its rebuttal testimony.

20 17. On January 30, 2013, RRUI filed a Response to School District's request to intervene,
21 stating that it did not object to the late request for intervention as long as the School District complied
22 with the existing procedural schedule.

23 18. On February 4, 2013, the School District was granted intervention, on the condition
24 that School District accept established deadlines for testimony and hearing.

25 19. On February 19, 2013, RUCO and Staff filed their surrebuttal testimony.

26 20. On February 26, 2013, RRUI filed an Unopposed Request for Extension of Time to
27 file rejoinder testimony. The Request was granted by Procedural Order dated February 28, 2013.

28 ...

1 21. On March 1, 2013, RRUI filed a Request for Change to Pre-hearing Conference, to
2 have the scheduled Pre-hearing Conference conducted telephonically. RRUI also filed a Motion to
3 Bifurcate, requesting that the hearing be conducted in two phases, with the first phase addressing
4 issues related to fair value and charges, and the second phase addressing the Company's request for a
5 DSIC.

6 22. On March 7, 2013, RUCO filed a Response to the Motion to Bifurcate. RUCO did not
7 oppose bifurcation as long as: 1) all parties were allowed to supplement the record on how the cost of
8 equity might be affected by the adoption of a DSIC mechanism; and 2) all pre-filed testimony related
9 to the DSIC or a DSIC-like mechanism was included in the record.

10 23. On March 8, 2013, Intervenors filed a Response to RRUI's Motion to Bifurcate.
11 Intervenors opposed bifurcation on the grounds that they believed that the DSIC is not a stand-alone
12 rate-making issue and its approval would affect the Company's financial risk and cost of equity.

13 24. On March 11, 2013, RRUI filed a Reply to RUCO's Response and a Reply to the
14 Intervenors' Response/Objection. RRUI objected to the Intervenors' request to file additional
15 testimony during the first phase of the proposed bifurcated proceeding and objected to RUCO's
16 condition to supplement the record in Phase 2 because RRUI believed it would defeat the purpose of
17 bifurcation and would result in re-litigating the cost of equity.

18 25. On March 12, 2013, Staff filed a Response in Support of Company's Motion to
19 Bifurcate. Staff believed that any proceeding on the DSIC should await the outcome of the decision
20 in the on-going AWC rate case because it was likely that any DSIC approved in the AWC docket
21 would be used as a template for other utilities.

22 26. By Procedural Order dated March 20, 2013, it was determined that bifurcation of the
23 proceeding as proposed by RRUI was not in the public interest given the issues raised by the parties
24 concerning single issue rate making and the overlap of a DSIC or DSIC-like mechanism with other
25 rate issues.

26 27. A Pre-hearing Conference convened telephonically on March 21, 2013, to discuss the
27 conduct of the hearing. In response to the ruling in the March 20, 2013, Procedural Order regarding
28 the issue of the DSIC, RRUI withdrew its request for a DSIC in this proceeding. The parties agreed

1 that the pre-filed testimony addressing the DSIC and its predecessor-mechanisms would be
2 withdrawn.

3 28. The Hearing convened on March 27, 2013, as scheduled, before a duly authorized
4 Administrative Law Judge, and continued over the following two days, concluding on March 29,
5 2013. Christopher Krygier, the utility rates and regulatory manager for Liberty Utilities, Greg
6 Sorensen, Vice President and General Manager for Liberty Utilities and Tom Bourassa, a rate
7 consultant, testified for RRUI; William Rigsby testified for RUCO;²¹⁰ and John Cassidy, Jian Liu and
8 Gordon Fox testified for Staff. Neither the County nor School District filed written testimony and did
9 not offer witnesses.

10 29. On April 23, 2013, RRUI, RUCO and Staff filed Final Schedules.

11 30. RRUI, RUCO, Intervenors, and Staff filed Closing Briefs on May 3, 2013.

12 31. Staff filed its Reply Brief on May 10, 2013; and RRUI and RUCO filed their Reply
13 Briefs on May 15, 2013. Intervenors did not file a Reply Brief.

14 32. The Commission received a number of comments from the public objecting to the
15 proposed rate increase.

16 33. RRUI's FVRB for its Water Division is \$7,791,209.

17 34. RRUI's FVRB for its Wastewater Division is \$4,790,738.

18 35. In the test year, RRUI's Water Division had adjusted operating income of \$454,769,
19 on total adjusted test year revenues of \$2,864,823. RRUI's test year rate of return was 5.88 percent.

20 36. In the test year, RRUI's Wastewater Division had adjusted operating income of
21 \$359,684 on total revenues of \$1,402,842, which was a 7.51 percent rate of return.

22 37. Utilizing a pro forma capital structure, as discussed herein, consisting of 20 percent
23 debt and 80 percent equity is reasonable under current circumstances, with a cost of debt of 5.7
24 percent and cost of equity of no more than 9.2 percent.

25 38. A fair value rate of return of 8.5 percent will provide RRUI with a reasonable and
26 appropriate return on its investment and will result in just and reasonable rates.

27

28 ²¹⁰ Mr. Rigsby adopted the testimony of Mr. Coley. Tr. at 435-36.

1 39. Based on a FVRB of \$7,791,209 for the Water Division and an authorized fair value
2 rate of return of 8.5 percent, RRUI is entitled to a revenue increase of \$335,737, or 11.72 percent,
3 over test year revenues.

4 40. Based on a FVRB of \$4,790,738 for the Wastewater Division, and a fair value rate of
5 return of 8.5 percent, RRUI is entitled to a revenue increase of \$78,847, or 5.62 percent, over test
6 year revenues.

7 41. As discussed herein, it is reasonable and in the public interest that RRUI track any
8 increases and decreases in the contract with the City of Nogales for the NWWTP such that in a future
9 rate case, the Company can seek to recover increased costs, or to credit ratepayers for lower costs,
10 that result from the contract true-up process.

11 42. As discussed herein, it is reasonable and in the public interest that RRUI file
12 documentation with Docket Control that it has incurred the authorized pension plan costs in 2013,
13 and that RRUI track any lower than authorized pension plan costs such that in the next rate case,
14 ratepayers can be credited for any authorized pension plan costs that were not actually made.

15 43. Staff's proposed rate design, modified to provide a 5 percent discount to School
16 District as reflected in the parties' Final Schedules and to provide the revenue requirement authorized
17 herein, is reasonable.

18 44. ADEQ regulates RRUI's water system under ADEQ PWS No. 12-011, and has
19 determined that the system has no deficiencies and is currently delivering water that meets water
20 quality standards required by A.A.C. Title 18, Chapter 4.

21 45. RRUI is located within the Santa Cruz AMA and is subject to its AMA reporting and
22 conservation requirements. ADWR has indicated that RRUI is currently in compliance with ADWR
23 requirements governing water providers and/or community water systems.

24 46. The Company has adequate water production and storage capacity to serve the
25 existing customer base and reasonable growth.

26 47. There are no delinquent Commission compliance items for RRUI.

27 48. RRUI has approved Curtailment Plan and Backflow Prevention Tariffs on file with the
28 Commission.

1 49. RRUI has ten approved BMP tariffs on file with the Commission.

2 50. The Company reported 807,817,000 gallons pumped, 678,845,000 gallons sold and
3 48,810,000 gallons used for flushing lines, construction, backwashing and fire suppression resulting
4 in a water loss of 9.92 percent for the test year.

5 51. ADEQ regulates the RRUI wastewater treatment plants under Permit No. 14919 and
6 52015, and has determined the systems are in compliance with ADEQ requirements.

7 52. RRUI has adequate wastewater treatment capacity to serve the existing customer base
8 and reasonable growth for both wastewater systems.

9 53. Staff recommends the following:

- 10 a. RRUI file documentation showing specific procedures followed by its operations
11 staff and steps taken to ensure that there is an accurate accounting of the amount of
12 water actually used for "Authorized Use" purposes, and that the documentation
13 should be filed as a compliance item with Docket Control within 60 days of the
14 effective date of the Commission Decision in this matter;
- 15 b. If the water used by "Authorized Use" in one month is more than 5,000,000
16 gallons the Company shall explain in detail the reason(s) for this use in its annual
17 water loss compliance reporting per Decision No. 72059;
- 18 c. The Company continue to record and monitor monthly water losses and repair any
19 leak as soon as it is discovered; and
- 20 d. RRUI be required to provide separate wastewater descriptions for its two
21 wastewater systems in future Commission Annual Reports, beginning with the
22 2013 Annual Report filed in 2014.

23 54. The Company does not object to Staff's recommendations. We find that they are
24 reasonable and should be adopted.

25 55. The Company should continue to evaluate ways to improve communications with its
26 Spanish-speaking customers, and should consult with Staff and RUCO to devise ways to inform its
27 customers about its low income tariff as well as to improve bi-lingual notice procedures for any
28 future rate cases.

CONCLUSIONS OF LAW

1. RRUI 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 RRUI and the subject matter of the Rate Application.

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

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

ORDER

IT IS THEREFORE ORDERED that Rio Rico Utilities, Inc. shall file with Docket Control, as a compliance item in this docket, by July 31, 2013, revised rate schedules setting forth the following rates and charges:

WATER DIVISION

<u>Monthly Usage Charge</u>	<u>Authorized Rates⁽¹⁾</u>
Meter Size (All Classes)	
5/8 x 3/4 inch	\$15.46
5/8 x 3/4 inch (low income)	13.14
3/4 inch	23.19
3/4 inch (low income)	19.71
1 inch	38.65
1 inch (low income)	32.85
1 1/2 inch	77.30
2 inch	123.68
3 inch	247.36
4 inch	366.50
6 inch	773.00
8 inch	1,236.80
10 inch	1,777.90
12 inch	3,323.90
Morningstar Ranch Community Association – 6 inch	549.00
Commodity Charge (per 1,000 gallons) all classes (less 15% for low income customers as applicable)	
5/8 x 3/4 inch meter	
First 3,000 gallons	\$1.49
3,001-9,000 gallons	2.98
Over 9,000 gallons	3.49
3/4 inch meter	
First 6,000 gallons	NA
Over 6,000 gallons	NA

1	First 4,500 gallons	2.98
	Over 4,500 gallons	3.49
2	1 inch meter	
3	First 15,000 gallons	NA
	Over 15,000 gallons	NA
4	First 22,500 gallons	2.98
	Over 22,500 gallons	3.49
5	1 ½ inch meter	
6	First 20,000 gallons	NA
	Over 20,000 gallons	NA
7	First 45,000 gallons	2.98
	Over 45,000 gallons	3.49
8	2 inch meter	
9	First 57,000 gallons	NA
	Over 57,000 gallons	NA
10	First 72,000 gallons	2.98
	Over 72,000 gallons	3.49
11	3 inch meter	
12	First 57,000 gallons	NA
	Over 57,000 gallons	NA
13	First 144,000 gallons	2.98
	Over 144,000 gallons	3.49
14	4 inch meter	
15	First 57,000 gallons	NA
	Over 57,000 gallons	NA
16	First 225,000 gallons	2.98
	Over 225,000 gallons	3.49
17	6 inch meter	
18	First 125,000 gallons	NA
	Over 125,000 gallons	NA
19	First 450,000 gallons	2.98
	Over 450,000 gallons	3.49
20	8 inch meter	
21	First 125,000 gallons	NA
	Over 125,000 gallons	NA
22	First 720,000 gallons	2.98
	Over 720,000 gallons	3.49
23	10 inch meter	
24	First 125,000 gallons	NA
	Over 125,000 gallons	NA
25	First 1,025,000 gallons	2.98
	Over 1,025,000 gallons	3.49
26	12 inch meter	
27	First 125,000 gallons	NA
	Over 125,000 gallons	NA
28	First 1,025,000 gallons	2.98
	Over 1,025,000 gallons	3.49

1	Morningstar Ranch Community Association	4.79
2	Fire Lines:	
3	Up to 8 inches	Per Rule ****
4	10 inches	Per Rule****
	12 inches	Per Rule ****
	Other Service Charges:	
5	Establishment	\$15.00
6	Establishment (After Hours)	25.00
7	Reconnection (Delinquent)	15.00
8	Reconnection (Delinquent) (After Hours)	NT
9	Meter Test (If correct)	15.00
10	Deposit	*
11	Deposit Interest	**
12	Re-establishment (within 12 months)	***
13	NSF Check	15.00
14	Late Payment Penalty	1.5% per mo.
15	Deferred Payment	1.5% per mo.
16	Moving Meter at Customer Request	At Cost
17	Service Calls – per hour/after hours (a)	NT
18	After hours service calls	50.00

(1) A 5 percent discount is applicable to entities whose primary function is education.

*Per Commission Rule A.A.C. R14-2-403 (B)

**Per Commission Rule A.A.C. R14-2-403(B)

***Per Commission Rule A.A.C. R14-2-403(D) – months off the system times the monthly minimum

****1 percent of monthly minimum for a comparable size meter, but no less than that \$5.00 per month. The service charge for fire sprinklers is only applicable for service line separate and distinct from the primary water service line.

(b) No charge for service calls during normal working hours.

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use and franchise tax, per commission Rules A.A.C. R14-2-408(5).

**Service and Meter Installation Charges
(Refundable pursuant to A.A.C. R14-2-405)**

Service Size	Service Line	Meter	Total
5/8 inch	At Cost	At Cost	At Cost
3/4 inch	At Cost	At Cost	At Cost
1 inch	At Cost	At Cost	At Cost
1 1/2 inch	At Cost	At Cost	At Cost
2 inch	At Cost	At Cost	At Cost
3 inch	At Cost	At Cost	At Cost
4 inch	At Cost	At Cost	At Cost
6 inch	At Cost	At Cost	At Cost
8 inch	At Cost	At Cost	At Cost
10 inch	At Cost	At Cost	At Cost
12 inch	At Cost	At Cost	At Cost

WASTEWATER DIVISION

<u>Monthly Usage Charge</u>	<u>Approved Rates⁽¹⁾</u>
<u>Meter Size (All Classes)</u>	
5/8 x 3/4 inch	\$49.00
5/8 x 3/4 inch (low income)	41.65
3/4 inch	56.50
3/4 inch (low income)	48.03
1 inch	69.10
1 inch (low income)	58.74
1 1/2 inch	102.00
2 inch	141.50
3 inch	246.50
4 inch	365.40
6 inch	694.40
8 inch	1,057.78
10 inch	1,585.07
12 inch	2,254.08
<u>Commodity Charge – per 1,000 gallons</u>	
<u>Commercial and Multi-Tenant Only</u>	
0 gallons to 7,000 gallons	--
Over 7,000 gallons	\$5.00
<u>Other Service Charges</u>	
Establishment	\$15.00
Establishment (After Hours)	NT
Reconnection (Delinquent)	15.00
Reconnection (Delinquent) After Hours	NT
Deposit	*
Deposit Interest	**
Re-establishment (within 12 months)	***
NSF Check	25.00
Late Payment Penalty	1.5 % per mo.
Deferred Payment	1.5% per mo.
Service Calls – per hour/after hours	NT
After Hours Service Charge	50.00
<u>Service Line Installation Charges</u>	
<u>Service Line Size</u>	
4 inch	At Cost
6 inch	At Cost
8 inch	At Cost
10 inch	At Cost
12 inch	At Cost

(1) A 5 percent discount is applicable to entities whose primary function is education.

*Per Commission Rule A.A.C. R14-2-603(B)

**Per Commission Rule A.A.C. R14-2-603(B)

*** Per Commission Rule A.A.C. R14-2-603(D) – Months off system times the monthly minimum

1 IT IS FURTHER ORDERED that the above rates and charges shall be effective for all service
2 provided on and after August 1, 2013.

3 IT IS FURTHER ORDERED that Rio Rico Utilities, Inc. shall notify its customers of the
4 rates and charges authorized herein, and their effective date, in a form acceptable to the
5 Commission's Utilities Division Staff, by means of an insert in its next regularly scheduled billing or
6 as a separate mailing.

7 IT IS FURTHER ORDERED that, in addition to the collection of its regular rates and
8 charges, Rio Rico Utilities, Inc. shall collect from its customers a proportionate share of any
9 privilege, sales or use tax per A.A.C. R14-2-409(D).

10 IT IS FURTHER ORDERED that within 60 days of the effective date of this Decision, Rio
11 Rico Utilities, Inc. shall file documentation with Docket Control as a compliance item, showing
12 specific procedures followed by its operations staff and steps taken to ensure that there is an accurate
13 accounting of the amount of water actually used for "Authorized Use" purposes.

14 IT IS FURTHER ORDERED that Rio Rico Utilities, Inc. shall record and monitor monthly
15 water losses and shall continue to file its annual water loss reports within 90 days of the end of each
16 calendar year; and if the water used by "Authorized Use" in one month is more than 5,000,000
17 gallons, Rio Rico Utilities, Inc. shall explain in detail the reason(s) for this use in its annual water loss
18 compliance reporting.

19 IT IS FURTHER ORDERED that Rio Rico Utilities, Inc. shall provide separate wastewater
20 descriptions for its two wastewater systems in future Commission Annual Reports, beginning with
21 the 2013 Annual Report filed in 2014.

22 IT IS FURTHER ORDERED that on a going forward basis, Rio Rico Utilities, Inc. shall
23 accurately track and record plant additions, plant retirements, depreciation expense and accumulated
24 depreciation, and that Rio Rico Utilities, Inc.'s failure to do so may subject the Company to
25 sanctions, fines or other penalties.

26 IT IS FURTHER ORDERED that by February 28, 2014, Rio Rico Utilities, Inc. shall file
27 with Docket Control, as a compliance filing, a statement verified by an officer that it funded the
28 Pension Plan in 2013 as authorized herein; and Rio Rico shall track any pension plan payments that

1 are lower than the amounts authorized herein, such that in a future rate case ratepayers can be
2 credited if the pension plan was not funded as authorized.

3 IT IS FURTHER ORDERED that Rio Rico Utilities, Inc. shall track any increases or
4 decreases in the contract price related to the Nogales Wastewater Treatment Plant, such that in a
5 future rate case, it may seek recovery of any increased costs, or propose to credit ratepayers with
6 lower costs, resulting from the contract true-up process with the City of Nogales.

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

8 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

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CHAIRMAN _____ COMMISSIONER _____

COMMISSIONER _____ COMMISSIONER _____ COMMISSIONER _____

IN WITNESS WHEREOF, I, JODI JERICH, 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 _____ 2013.

JODI JERICH
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____

1 SERVICE LIST FOR: RIO RICO UTILITIES, INC.

2 DOCKET NO.: WS-02676A-12-0196

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