

OPEN MEETING ITEM

COMMISSIONERS
BOB STUMP - Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

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ARIZONA CORPORATION COMMISSION

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AUG 26 2013

DATE: AUGUST 26, 2013

DOCKET NO.: WS-03478A-12-0307

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TO ALL PARTIES:

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

FAR WEST WATER AND SEWER, 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:

SEPTEMBER 4, 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:

SEPTEMBER 10, 2013 AND SEPTEMBER 11, 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 JERICH
EXECUTIVE DIRECTOR

1200 WEST WASHINGTON STREET; PHOENIX, ARIZONA 85007-2927 / 400 WEST CONGRESS STREET; TUCSON, ARIZONA 85701-1347

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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 FAR WEST WATER AND SEWER, INC., AN
10 ARIZONA CORPORATION, FOR A
11 DETERMINATION OF THE CURRENT FAIR
12 VALUE OF ITS UTILITY PLANT AND
13 PROPERTY AND FOR INCREASES IN ITS
14 WASTEWATER RATES AND CHARGES BASED
15 THEREON FOR UTILITY SERVICE.

DOCKET NO. WS-03478A-12-0307

DECISION NO. _____

OPINION AND ORDER

11 DATES OF HEARING: February 20, 2013 (Commissioners' Public Comment
12 Meeting in Yuma, Arizona); April 17, 2013 (Pre-
13 Hearing Conference); April 22, 23, 24, 25, and 26, 2013
(Evidentiary Hearing)

14 PLACE OF HEARING: Phoenix, Arizona

15 ADMINISTRATIVE LAW JUDGE: Dwight D. Nodes

16 APPEARANCES: Mr. Craig A. Marks, CRAIG A. MARKS, PLC, on
17 behalf of Far West Water & Sewer, Inc.;

18 Mr. Jeffrey W. Crockett, BROWNSTEIN HYATT
19 FARBER SCHRECK, on behalf of Spartan Homes &
20 Construction, Inc.;

21 Ms. Michelle Wood and Mr. Daniel Pozefsky, on behalf
22 of the Residential Utility Consumer Office;

23 Mr. Robert Gilkey and Mrs. Barbara Gilkey, in propria
24 persona;

25 Mr. Robert Rist, in propria persona; and

26 Mr. Wesley Van Cleve and Ms. Robin Mitchell, Staff
27 Attorneys, Legal Division, on behalf of the Utilities
28 Division of the Arizona Corporation Commission.

BY THE COMMISSION:

I. INTRODUCTION AND PROCEDURAL HISTORY

On July 6, 2012, Far West Water & Sewer, Inc. ("Far West" or "Company") filed the above-

1 captioned rate application with the Arizona Corporation Commission ("Commission"). With its
2 application, the Company filed supporting schedules and the direct testimony of Ray L. Jones.

3 On July 24, 2012, Spartan Homes & Construction, Inc. ("Spartan Homes" or "Spartan") filed
4 an Application for Leave to Intervene.

5 On July 31, 2012, Far West filed a Notice of Payment to Spartan Homes.

6 On July 31, 2012, Far West filed revised schedule pages to Mr. Jones' direct testimony.

7 On August 2, 2012, the Commission's Utilities Division ("Staff") filed a Letter of Sufficiency
8 indicating that Far West's application met the sufficiency requirements of A.A.C. R14-2-103, and
9 classifying the Company as a Class A Utility.

10 On August 3, 2012, the Residential Utility Consumer Office ("RUCO") filed an Application
11 to Intervene.

12 On August 3, 2012, Far West filed a Response in Opposition to Spartan Homes' Application
13 to Intervene.

14 On August 27, 2012, a Procedural Order was issued granting RUCO's Application to
15 Intervene and denying Spartan Homes' Application for Leave to Intervene.

16 On August 30, 2012, a Rate Case Procedural Order was issued setting a hearing on the
17 application to commence April 22, 2013, and setting associated procedural deadlines.

18 On August 30, 2012, Spartan Homes filed a Request for Reconsideration of Denial of
19 Application for Leave to Intervene.

20 On August 31, 2012, RUCO filed a Response in Support of Spartan Homes' Motion for
21 Reconsideration.

22 On September 4, 2012, Robert and Barbara Gilkey ("Gilkeys") filed a Motion to Intervene.

23 On September 4, 2012, a Procedural Order was issued granting Spartan Homes intervention.

24 On September 18, 2012, a Procedural Order was issued granting intervention to the Gilkeys.

25 On September 25, 2012, Robert Rist filed a Motion to Intervene.

26 On October 9, 2012, Rodney and Kim Taylor filed a Motion to Intervene.

27 On October 10, 2012, a Procedural Order was issued granting intervention to Robert Rist.

28 On October 22, 2012, a Procedural Order was issued granting intervention to Rodney and

1 Kim Taylor.

2 On October 29, 2012, Seth and Barbara Davis filed a Motion to Intervene.

3 On October 29, 2012, Jerry Durden filed a Motion to Intervene.

4 On November 8, 2012, Far West filed affidavits of mailing and publication of the required
5 public notice.

6 On November 15, 2012, a Procedural Order was issued granting intervention to Jerry Durden
7 and Seth and Barbara Davis.

8 On December 24, 2012, the Gilkeys and Mr. Rist jointly filed a Motion for Public Comment
9 Meeting in Yuma, Arizona.

10 On December 24, 2012, RUCO filed a Response to Motion for Public Comment in Yuma,
11 Arizona.

12 On December 31, 2012, the Gilkeys filed a letter requesting that Far West provide all data
13 requests and responses by the Company.

14 On January 4, 2013, Staff filed a Request for Change to the Procedural Schedule.

15 On January 8, 2013, RUCO filed a Response to Request for Change to the Procedural
16 Schedule.

17 On January 16, 2013, a Procedural Order Modifying Filing Deadlines was issued.

18 On January 25, 2013, a Procedural Order was issued scheduling a public comment meeting in
19 Yuma for February 20, 2013, and directing Far West to mail notice of the public comment meeting to
20 its customers.

21 On February 6, 2013, the Gilkeys filed a letter requesting an extension of time for filing their
22 direct testimony.

23 On February 6, 2013, Mr. Rist filed his direct testimony.

24 On February 8, 2013, a Procedural Order was issued granting the Gilkeys' request.

25 On February 8, 2013, RUCO filed the direct testimony of William Rigsby, Timothy Coley,
26 Royce Duffett, and Thomas Fish.

27 On February 11, 2013, the Gilkeys filed their direct testimony.

28 On February 11, 2013, William and Margaret Ott filed a Motion to Intervene with attached

1 comments.

2 On February 13, 2013, Staff filed the direct testimony of Gerald Becker, Jian Liu, and John
3 Cassidy; and Spartan Homes filed the direct testimony of Brian Householder.

4 On February 15, 2013, Far West filed an affidavit certifying that mailing of notice of the
5 public comment meeting was completed in accordance with the January 25, 2013, Procedural Order.

6 On February 19, 2013, Staff filed a Request to Change Procedural Schedule Re: Rate Design
7 Testimony.

8 On February 19, 2013, the Gilkeys and Mr. Rist jointly filed their direct rate design testimony.

9 On February 20, 2013, a Procedural Order was issued granting Staff's request to modify the
10 rate design testimony filing deadline.

11 On February 20, 2013, the Commission conducted a public comment meeting in Yuma, and
12 received verbal comments from numerous customers of Far West.¹

13 On February 21, 2013, RUCO filed the direct rate design testimony of Mr. Coley; and Staff
14 filed the direct rate design testimony of Mr. Becker.

15 On February 25, 2013, a Procedural Order was issued denying intervention to William and
16 Margaret Ott, but indicating their comments would be treated as public comment in this matter.

17 On February 26, 2013, RUCO filed Notice of Filing Revised Schedules for Mr. Coley's rate
18 design testimony.

19 On March 6, 2013, Far West filed a Motion to Extend Deadline for its rate design rebuttal
20 testimony.

21 On March 11, 2013, Far West filed the rebuttal testimony of Mr. Jones.

22 On March 12, 2013, a Procedural Order was issued granting Far West's request for an
23 extension of time to file its rebuttal rate design testimony.

24 On March 13, 2013, Far West filed the rebuttal rate design testimony of Mr. Jones.

25 On March 21, 2013, RUCO filed a Motion to Continue Time to File Surrebuttal Testimony on
26 Rate Design.

27

28 ¹ During the pendency of this case, a number of Far West customers have also filed written comments and called the Commission's Consumer Services Division expressing opposition to the Company's rate increase request.

1 On March 22, 2013, the Gilkeys and Mr. Rist filed a Motion to Appoint Interim Manager and
2 Order Forensic and Operational Audits.

3 On March 26, 2013, a Procedural Order Modifying Filing Deadline was issued granting
4 RUCO's request for an extension of time to file surrebuttal rate design testimony.

5 On March 28, 2013, Commissioner Bitter Smith filed a letter in the docket asking Staff and
6 other parties to provide additional information regarding the need for an interim manager.

7 On March 29, 2013, Staff filed the surrebuttal testimony of Mr. Becker, Mr. Liu, and Mr.
8 Cassidy; RUCO filed the surrebuttal testimony of Mr. Rigsby, Mr. Coley, Mr. Duffett, and Dr. Fish;
9 and Spartan Homes filed the surrebuttal testimony of Mr. Householder.

10 On April 1, 2013, the Gilkeys and Mr. Rist filed their joint surrebuttal testimony.

11 On April 3, 2013, Staff filed the surrebuttal rate design testimony of Mr. Becker; RUCO filed
12 the surrebuttal testimony of Mr. Coley; and the Gilkeys and Mr. Rist filed their joint surrebuttal rate
13 design testimony.

14 On April 9, 2013, the Gilkeys and Mr. Rist filed a Joint Response to Commissioner Bitter
15 Smith's letter.

16 On April 11, 2013, RUCO filed a Motion to Allow Telephonic Testimony by Dr. Fish.

17 On April 15, 2013, Staff filed a Memorandum in response to Commissioner Bitter Smith's
18 letter regarding appointment of an interim manager.

19 On April 17, 2013, Far West filed the rejoinder testimony of Mr. Jones and a summary of his
20 pre-filed testimony.

21 On April 17, 2013, a pre-hearing conference was conducted to discuss scheduling of
22 witnesses and other procedural matters.

23 On April 18, 2013, Staff and RUCO filed summaries of their respective witnesses' pre-filed
24 testimony.

25 On April 19, 2013, Spartan Homes, the Gilkeys and Mr. Rist filed summaries of their pre-
26 filed testimony.

27 On April 19, 2013, Far West filed a Response to Intervenors' Motion regarding the request for
28 an interim manager and forensic and operational audits.

1 On April 22, 2013, the evidentiary hearing commenced beginning with public comment and
2 opening statements. The hearing continued on April 23, 24, 25, and 26, 2013. Far West, RUCO,
3 Spartan Homes, and Staff appeared through counsel, and the Gilkeys and Mr. Rist appeared in
4 propria persona.²

5 On April 23, 2013, Far West filed a letter in response to customer complaints made to the
6 Arizona Department of Environmental Quality (“ADEQ”) regarding the Company’s operations.

7 On April 25, 2013, counsel for Spartan Homes filed a letter stating that he had been retained
8 to represent New Sun Homes, LLC, regarding collection of unpaid refunds allegedly due from Far
9 West under water and sewer main extension agreements.

10 On May 3, 2013, Final Schedules were filed by Far West, Staff, and RUCO.

11 On May 13, 2013, the Gilkeys and Mr. Rist filed “final schedules” stating that they “accept
12 RUCO’s Phase I schedules with a residential rate of no more than \$35.32, with no Phase II increase,
13 and contingent on installing an interim manager, performing a forensic audit and obtaining an
14 accurate bill count.”

15 On June 10, 2013, the Gilkeys and Mr. Rist filed their joint initial brief.

16 On June 11, 2013, Far West, RUCO, Spartan Homes, and Staff filed their initial briefs.

17 On June 28, 2013, Far West filed an Informational Filing Concerning Improper Debt
18 Collection Practices.

19 On June 28, 2013, the Gilkeys and Mr. Rist filed their joint reply brief.

20 On July 2, 2013, Far West and RUCO filed their reply briefs.

21 On July 2, 2013, Staff filed a notice that it would not be filing a reply brief.

22 II. APPLICATION

23 Far West is a “C” corporation that was issued a Certificate of Convenience and Necessity
24 (“CC&N”) in Decision No. 60799 (April 8, 1998). In that Decision, the CC&N of an affiliated
25 company, H&S Developers, Inc. (“H&S” or “H&S Developers”) dba Far West Water Company and
26 Far West Sewer Company, was transferred to Far West. The Company’s current wastewater rates

27 _____
28 ² The other intervenors, Rodney and Kim Taylor, Seth and Barbara Davis, and Mr. Durden, did not appear at or participate in the hearings.

1 were approved by Decision No. 69335 (February 20, 2007), based on a 2004 calendar test year and
2 OCRB of \$1,549,650. (Ex. A-1, at 5.)

3 Far West provides water and wastewater utility service in Yuma County, Arizona to
4 approximately 15,500 water customers and approximately 7,800 wastewater customers. The
5 application in this docket involves only the wastewater division of Far West, which includes
6 approximately 7,067 residential customers, 44 commercial customers, and 4 recreational vehicle
7 ("RV") parks containing 713 spaces. (Ex. A-1, at 3.) Most of Far West's wastewater customers are
8 also water customers of the Company.

9 In its application, Far West sought an overall rate increase of \$3,866,046, or 173.52 percent
10 over test year revenues. For residential customers, the application requested an increase of \$40.90
11 per month, from the current rate of \$21.75 to \$62.65, or 188 percent. (*Id.* at RLJ-DT3, Sched. H-4.)
12 The test year in this case is the 12-month period ending December 31, 2011. However, the Company
13 also proposed several pro forma adjustments to reflect known and measurable changes to rate base,
14 expenses, and revenues, and to recognize certain normalized levels of revenues, expenses, and rate
15 base. (*Id.* at 8.)

16 Due to certain concessions during the pendency of the case, Far West's final revenue
17 requirement position seeks a rate increase of \$3,482,612, resulting in operating income of
18 \$1,518,726, for a 7.4 percent rate of return on an original cost rate base ("OCRB")³ of \$20,523,327.
19 (Co. Final Sched. A-1.) For residential customers, the Company's final schedules request an increase
20 of \$36.34 per month, from the current rate of \$21.75 to \$58.09, or 167 percent.⁴ (*Id.* at H-4.)

21 As set forth in its final schedules, Staff recommends a rate increase of \$3,284,021, resulting in
22 operating income of \$1,422,238, for a 7.4 percent rate of return on OCRB of \$19,219,435. (Staff
23 Final Sched. GWB-1.) For residential customers, Staff's final schedules recommend an increase of
24 \$34.24 per month, from the current rate of \$21.75 to \$55.99, or 157.4 percent. (*Id.* at GWB-2.)

25 According to its final schedules, RUCO proposes a rate increase of \$2,754,266, resulting in

26 ³ Far West did not request reconstruction cost new depreciated ("RCND") rate base treatment and therefore the
27 Company's OCRB will be considered as its fair value rate base ("FVRB") in this proceeding.

28 ⁴ As will be discussed in further detail below, Far West and Staff are proposing that their respective recommended rates
be phased in so that 50 percent of the increase would be effective after certain conditions are met, and the full rate
increase would be effective six months later. (*See* Ex. A-8.) RUCO also proposes a 50 percent initial rate phase-in.

1 operating income of \$1,207,577, for a 7.24 percent rate of return on OCRB of \$16,679,237. (RUCO
2 Final Sched. TJC-1.) For residential customers, RUCO's final schedules propose a total increase of
3 \$27.13 per month, from the current rate of \$21.75 to \$48.88, or 124.7 percent. (*Id.* at TJC-RD 3.)

4 **III. RATE BASE ISSUES**

5 By the end of the hearing in this matter, there were three remaining rate base issues in dispute
6 between Far West and Staff: the Zenon⁵ Treatment Equipment at the Seasons wastewater treatment
7 plant ("WWTP"); the amount of allowance for funds used during construction ("AFUDC"); and
8 capitalization of management fees paid to the husband of one of the Company's two shareholders,
9 Andrew Capestro.⁶ The only rate base issue in dispute between Far West and RUCO relates to
10 RUCO's proposed disallowance of approximately 30 percent of the Company's plant in service due
11 to alleged excess capacity. Each of these issues is discussed below.

12 **Zenon Treatment Equipment at Seasons WWTP**

13 Staff recommends disallowance from rate base of \$1,060,096 related to Zenon treatment
14 equipment that was relocated from the Del Oro WWTP to the Seasons WWTP, but was not
15 operational at the end of the 2011 test year or at the time of Staff's engineering inspection on January
16 9, 2013. (Ex. S-1, Eng. Report at 5.) Staff asserts that the equipment should not be included in rate
17 base because it was not in service at the end of the test year, or during Staff's inspection in January
18 2013, and the equipment was not placed back into service until nearly one-and-a-half years after the
19 end of the test year.

20 Far West contends that the Zenon equipment was in service at the Del Oro plant between
21 September 30, 2006 and December 22, 2011, and the equipment was only temporarily out of service
22 because it was being relocated. (Ex. A-2, at 12-13.) Mr. Jones testified at the hearing that the Zenon
23 equipment became operational at the Seasons plant on April 16, 2013. (Tr. 50.) The Company argues
24 that it would be inequitable to disallow the Zenon equipment from plant in service because it was
25 operational during most of the test year and it will be in service when the rates in this case go into
26 effect. Mr. Jones stated that it would be unfair to disallow the Zenon equipment because Far West's

27 ⁵ "Zenon" refers to the wastewater treatment equipment vendor Zenon Environmental Corporation.

28 ⁶ There is also a difference in the amount of working capital allowance due to treatment of the disputed issues; but not as to the methodology for calculating working capital.

1 customers have received a benefit from the equipment for more than five years and will continue to
2 benefit from the plant on a going forward basis. (Ex. A-2, at 13.)

3 We agree with the Company that the Zenon equipment should be included in rate base given
4 its prior five year history of providing service at the Del Oro WWTP, and due to the equipment's
5 operational status at the time the hearing was conducted and during the period rates in this case will
6 be in effect. Although we understand Staff's concern with inclusion of equipment that was not in
7 service for nearly a year-and-a-half after the end of the test year, the fact that the equipment was
8 being relocated, and therefore only temporarily out of service; its prior five years of providing service
9 to customers; and that it is now used and useful plant in the provision of service to customers, weighs
10 in favor of inclusion in plant in service. We therefore adopt Far West's position on this issue.

11 AFUDC

12 As described in Staff witness Becker's testimony, on March 13, 2006 and October 31, 2006,
13 Far West entered into Consent Orders with ADEQ related to several notices of violation ("NOVs")
14 issued by ADEQ to Far West. On October 30, 2007, the Commission issued Decision No. 69950,
15 authorizing Far West to incur indebtedness up to \$25,215,000 in order to pay off prior loans and
16 finance improvements to its wastewater system required under the Consent Orders with ADEQ. (Ex.
17 S-5, at 8-9.) Despite the financing approval, the Company was unable to complete all of the required
18 projects; many bills related construction work were not paid on time; and Far West incurred late fees,
19 legal fees, and debt restructuring costs as a result. (*Id.* at 9.) The unpaid bills were for major capital
20 addition projects for the Section 14 WWTP, Palm Shadows force main, Del Oro WWTP, and Palm
21 Shadows lift station. (*Id.*) Mr. Becker stated that the Company's failure to pay Zenon resulted in
22 Zenon's refusal to allow Far West to exercise operational control of the Section 14 and Del Oro
23 plants until payment arrangements were made. (*Id.*) After payment arrangements with Zenon were
24 made, the Section 14 WWTP was placed in service on August 24, 2011; the Palm Shadows lift
25 station and force main were placed in service on October 11, 2011; and the Del Oro WWTP was
26 placed in service on December 22, 2011. (*Id.* at 10.) Mr. Becker testified that the deficiency in loan
27 proceeds available to make the required improvements was exacerbated by the Company's decision
28 to use approximately \$1.9 million of the loan proceeds for water division improvements, when the

1 financing approved by the Commission was specifically limited for use in the wastewater system
2 improvements described in the financing application filed by Far West. (*Id.* at 11.) Although the
3 Company initially sought to include the late fees, legal fees and debt restructuring costs related with
4 these projects, it subsequently agreed to remove them from its request for inclusion in rate base. (Ex.
5 A-2, at 6.)

6 With respect to the overall amount of AFUDC that should be allowed for the projects
7 associated with the Consent Order, however, the Company and Staff remain in disagreement. Staff
8 recommends that AFUDC for the projects be limited to an 18-month period following the
9 Commission's approval of Far West's finance application in Decision No. 69950 (October 30, 2007).
10 Staff witness Becker stated that the 18-month AFUDC cutoff date (*i.e.*, April 30, 2009) should have
11 been more than adequate for the Company to complete the projects, and that customers should be
12 held harmless from the interest expenses associated with the construction delays that were "caused by
13 the Company's poor management decisions." (Ex. S-5, at 13.) Mr. Becker pointed out that the April
14 30, 2009 date is, coincidentally, also approximately 6 months after the date the Zenon bills became
15 overdue in October 2008, and closely approximates the 6-month period between when the Zenon
16 obligation was resolved (March 31, 2011) and when the plant items were placed in service between
17 August and December 2011. (*Id.*)

18 According to Far West witness Jones, although Staff's April 30, 2009 cutoff date is a
19 reasonable date for when the work could have been completed, the AFUDC accrued during the 6-
20 month period after incurring the Zenon obligation did not take into account the large unpaid Zenon
21 bills or significant additional costs to complete the project. (Ex. A-2, at 5.) Mr. Jones stated that if
22 AFUDC were to be calculated during the actual final 6 months of construction during 2011, the
23 calculation would include all bills, as well as the additional costs needed to complete the projects and
24 the then-paid Zenon bills. (*Id.*) Far West claims that the AFUDC accrued during the 6-month delay
25 period is substantially less than what would have been accrued if the project had been completed
26 during the same 6-month period; and it is therefore inconsistent for Staff to claim that construction
27 should have been completed in 6 months, but fail to include all the AFUDC for construction that
28 should have been completed in those 6 months. (*Id.*) In order to give effect to its claim, Far West

1 agreed to reduce Staff's recommended AFUDC disallowance by an amount equal to one-half of the
2 interest charges and late fees incurred on the unpaid bills, which the Company asserts is "a fair proxy
3 for the understatement of AFUDC created by Staff's proposed adjustment." (*Id.*)

4 We agree with Staff that the Company's management decisions were directly responsible for
5 the failure to complete the projects required by the ADEQ Consent Order in a timely fashion. The
6 record shows that Far West substantially underestimated the capital needed to make the required
7 wastewater system improvements; failed to infuse equity that could have avoided the delays that were
8 experienced, despite assurances in a prior case that it would do so (increase its equity ratio); and
9 diverted almost \$2 million of the loan proceeds to its water division despite the obligation pursuant to
10 Decision No. 69950 to use the financing only for the specified wastewater projects. (Ex. S-5, at 11.)
11 Accordingly, we will adopt Staff's position on this issue and disallow from rate base \$1,473,172.
12 (Staff Final Sched. GWB-7.)

13 Management Fees

14 Staff recommends disallowance of \$201,562 for capitalized construction management fees
15 (plus accumulated depreciation) from Far West's plant in service that were paid to Mr. Capestro, the
16 husband of one the Company's owners, for "construction management services." (Ex. S-5, at 16.)
17 Staff claims that these capitalized costs should be disallowed because they were mostly incurred in
18 2010 and 2011, long after the date when the plant improvement projects should have been completed
19 if Far West had paid its bills on time. Mr. Becker added that the management fees paid to Mr.
20 Capestro were in addition to project management fees of more than \$1.4 million paid to Coriolis, a
21 consulting and engineering firm retained by Far West, for project management and other services.
22 (*Id.*)

23 Far West contends that although Coriolis was paid for construction management fees, its
24 contract was terminated in April 2009 with over \$750,000 remaining unpaid on the contract. (Ex. A-
25 2, at 7.) Mr. Jones stated that Mr. Capestro did not duplicate the services provided by Coriolis, but
26 rather provided services that Coriolis would otherwise have provided if the contract had not been
27 terminated. He claims that Mr. Capestro is a full-time contractor to Far West, and provides the
28 services equivalent to a vice-president of operations. (*Id.*) Far West asserts that because Mr.

1 Capestro's services were provided during the test year for construction management they should be
2 included as capitalized costs in rate base. (*Id.*) However, Mr. Jones stated that the Company was
3 willing to compromise on this issue and accept half of Staff's recommended disallowance. (*Id.*)

4 We agree with Staff's recommended disallowance of capitalized construction management
5 fees paid to Mr. Capestro. As Staff points out, had Far West completed the necessary wastewater
6 construction projects in a timely manner by April 2009, at approximately the same time that Coriolis'
7 contract was terminated, there would have been no need for the Company to retain Mr. Capestro's
8 services. We will therefore disallow from plant in service \$201,562 (plus accumulated depreciation)
9 as recommended by Staff.

10 **Excess Capacity**

11 RUCO proposes that approximately 30.1 percent of Far West's wastewater plant in service be
12 disallowed as representing "excess capacity." (Ex. R-9, at 7.) RUCO witness Duffett stated that Far
13 West's wastewater system is currently comprised of six separate treatment plants with a total design
14 capacity of 2,332,500 gallons per day ("gpd"). (*Id.* at 3.) Multiplying the customer base of 7,824
15 customers by the ADEQ design standard of 240 gallons per household per day for sewage treatment,
16 he calculated that the Company's facilities should have a design capacity of 1,877,760 gpd to meet
17 expected average flows, and 2,065,536 gpd if a growth factor of 10 percent is added for future use.
18 (*Id.* at 4.) Mr. Duffett indicated that under these criteria, Far West would have a total excess design
19 capacity of 11.4 percent. (*Id.* at 5.)

20 However, Mr. Duffett stated that based on Far West's 2011 Annual Report, its actual average
21 flow that year was 754,704 gpd, or 32.4 percent of the Company's rated capacity, and its system wide
22 peak demand was 1,195,000 gpd, or 51.2 percent of the 2,332,500 gpd rated capacity. (*Id.* at 6.) Mr.
23 Duffett claimed that his calculation shows that Far West has a 48.8 percent overinvestment in
24 wastewater plant, or 1,137,500 available for future use (*i.e.*, not currently "used and useful"). (*Id.*) In
25 explaining the term "used and useful," Mr. Duffett indicated, as an example, that if only 50 percent of
26 a plant is being used by current customers, those customers should only be required to pay for the 50
27 percent of the plant they are using and future customers should be obligated to pay for the remainder
28 of the plant when it used to serve them. (*Id.* at 6-7.) Based on his analysis of the two excess capacity

1 calculations, Mr. Duffett averaged the 11.4 percent from the ADEQ design standards with the
2 historical 48.8 percent calculation and arrived at a determination that Far West has excess wastewater
3 treatment capacity of 30.1 percent, which is the amount he claims should be disallowed from plant in
4 service. (*Id.* at 7.)

5 Both Far West and Staff disagree with RUCO's excess capacity analysis. Company witness
6 Jones stated that RUCO's proposal is seriously flawed because its analysis is made on a system-wide
7 basis rather than on an individual facility basis; the design capacity used by RUCO is incorrect; and
8 RUCO's analysis is based on test year actual flows, plus 10 percent for future growth, instead of a
9 five-year growth projection typically employed by the Commission in making used and useful
10 determinations. (Ex. A-2, at 14.) Mr. Jones stated that because each wastewater treatment plant
11 serves a separate and distinct area, and flows cannot be diverted between plants, evaluating the
12 capacity of the system as a whole is "mostly meaningless." (*Id.*) He indicated that from a ratemaking
13 perspective, RUCO's analysis provides no meaningful information as to what specific plant costs
14 should be excluded from rate base due to excess capacity. (*Id.*)

15 Far West also claims that the design capacity used in RUCO's analysis is flawed because the
16 total permitted capacity of the plants at the end of the test year was 1,438,500 gpd, the design
17 capacity of the plants is 2,057,500 gpd, and the ultimate design capacity of the plants is 2,285,000
18 (due to the construction of certain plants in phases). (*Id.* at 15.) Mr. Jones added that even if a
19 system-wide plant analysis were to be used, it should have been based on 2,057,500 gpd, which is 11
20 percent below RUCO's proposed number, and less than the capacity required under the ADEQ
21 requirements calculated by RUCO. (*Id.*) The Company also contends that RUCO's use of a 10
22 percent growth factor understates the expected growth, which Staff witness Liu estimated is between
23 100 and 400 customers per year, resulting in a five-year growth projection that is approximately 60
24 percent higher than RUCO's estimate. (*Id.* at 16.)

25 Mr. Jones conceded that Far West has capacity at its Section 14 WWTP that is not currently
26 used and useful, but claims the Company recognized this fact by removing \$2,165,201 from its plant
27 in service in its application. (Ex. A-2, at 17; Ex. A-4, at 9.) He contends that RUCO witness Fish's
28 analysis erroneously calculated the dollar amount of plant in service that is not used and useful by

1 using an incorrect starting point to determine the plant disallowance and by failing to consider that
2 the Company had already made the Section 14 plant adjustment in its application. (Ex. A-2, at 17.)
3 According to Mr. Jones, by failing to recognize Far West's adjustment for non-used and useful plant,
4 Dr. Fish's proposal effectively removes the plant amount a second time because RUCO's adjustment
5 is applied to the already adjusted capacity of the Section 14 plant, as opposed to the unadjusted
6 capacity, and thereby overstates the proposed disallowance by approximately \$1.5 million. (*Id.*; Ex.
7 A-4, at 9-10.)

8 Mr. Jones claims that Dr. Fish's second error is even more severe because he proposes to
9 apply RUCO's 30.1 percent plant disallowance to the entirety of Far West's depreciable plant in
10 service, rather than to only treatment plant capacity. (Ex. A-2, at 18.) Mr. Jones stated that because
11 much of the Company's plant in service is comprised of plant such as pipelines, service lines to
12 customers, lift stations, and general plant, RUCO's proposed adjustment substantially overstates the
13 disallowance for excess treatment capacity, which should be limited to wastewater treatment plant
14 costs. (*Id.*) Mr. Jones asserts that RUCO witness Coley further compounded the error of RUCO's
15 analysis by reducing every single depreciable plant account by 30.1 percent, including plant accounts
16 for items such as force and gravity mains, customer services, office furniture, vehicles, and tools,
17 which Mr. Jones points out are accounts not related to treatment plants or capacity. (*Id.* at 19.)

18 Staff agrees with the Company that Far West does not have excess capacity, which Mr. Liu
19 defined as "constructed plant facilities that exceed the system requirements within a reasonable
20 planning period." (Ex. S-2, at 1.) He stated that in determining whether a company has excess
21 capacity, Staff typically looks at the average daily flow from the peak month of the year and a five-
22 year planning horizon. (*Id.*) In this case, Staff evaluated each of the treatment plants and determined
23 that during the test year, each of the plants' treatment capacity utilization rate on the peak day
24 exceeded its treatment capacity rating, except for the Section 14 and Del Oro plants, which had
25 utilization rates of 75 percent and 83 percent, respectively. (*Id.* at 2.) Mr. Liu testified that Far West
26 currently has 7,824 customers, and the Company estimates it will have 1,100 to 1,200 new customers
27 by the end of 2016. (*Id.*) Applying the ADEQ 240 gpd standard, he indicated Far West's design
28 capacity should be 2,160,000 by the end of 2016, and that if the Company completes all of its

1 ongoing plant improvements it would have a design capacity of 2,2285,000, a difference of only
2 125,000 gpd. (*Id.* at 3.) Mr. Liu therefore concluded that Far West's wastewater treatment plants do
3 not have excess capacity. (*Id.*)

4 We agree with the Company and Staff that no excess capacity adjustment is justified in this
5 proceeding. RUCO's proposed across-the-board 30.1 percent disallowance of all depreciable plant in
6 service accounts is unreasonable for several reasons. First, and foremost, RUCO's analysis of Far
7 West's treatment plants on a system-wide basis fails to recognize that during the test year, and
8 currently, the Company's treatment plants are operated on an individual basis and are not capable of
9 diverting flows between service area pockets. Thus, each plant must be evaluated on an individual
10 basis and, as shown in Mr. Liu's testimony, 4 of the 6 treatment plants actually had peak day
11 utilizations rates that exceeded their rated capacity during the test year. (Ex. S-2, at 2.) With respect
12 to the Section 14 WWTP, which the Company acknowledged was built to accommodate two
13 additional phases to meet future growth, more than \$2 million was excluded from plant in service in
14 the Company's application to recognize that a portion of the plant is not currently used and useful.
15 We find that, when Far West's wastewater system is evaluated on a proper as-engineered basis, there
16 is no excess treatment capacity that warrants a disallowance as advocated by RUCO.

17 Even if we were to accept the premise of RUCO's assertion that the Company's wastewater
18 system should be evaluated on a system-wide basis, without regard for engineering and operational
19 constraints, we believe RUCO's analysis is flawed for the reasons identified by the Company and
20 Staff witnesses. RUCO's analysis is based on a system-wide design capacity of 2,332,500 gpd,
21 although the Company's witness explained that the test year permitted capacity was 1,438,500 gpd,
22 the test year design capacity was 2,057,500 gpd (due to the Section 14 plant being built in three
23 phases), and the ultimate design capacity of all treatment plants combined is 2,285,000 gpd. (Ex. A-2,
24 at 15.) Mr. Jones explained that treatment plants are often constructed to a larger size to take
25 advantage of economies of scale and ultimately lower costs on a per gallon of capacity basis. (Tr.
26 359.) He stated that the aquifer protection permit ("APP") issued by ADEQ for the Section 14
27 WWTP shows a current permitted capacity of 681,000 gpd, with two additional phases planned that
28 would result in an ultimate design capacity of 1.3 million gpd with the installation of three additional

1 membrane cassettes and construction of two additional vadose (discharge) wells. (*Id.* at 359-363; Ex.
 2 A-6.) Despite RUCO's claims that no additional approvals are necessary to increase the permitted
 3 capacity, the APP currently in effect for the Section 14 plant specifically states that Far West must
 4 "obtain approval for each phase of construction." (Ex. A-6, at 2.) Moreover, as indicated above, in its
 5 application the Company excluded \$2,165,000 from plant in service at the Section 14 plant, based on
 6 "what percentage of the cost in each NARUC plant account was attributable to those future phases."
 7 (Tr. 363.)

8 RUCO also failed to take into account the Company's adjustment to its test year capacity at
 9 the Section 14 plant by applying the proposed 30.1 percent disallowance to the already adjusted plant
 10 in service at that plant. Even more significantly, RUCO applied its proposed excess capacity
 11 adjustment to all depreciable plant accounts, including accounts for furniture, vehicles and tools,
 12 which are clearly unrelated to RUCO's attempt to exclude treatment plant that it claimed represents
 13 excess capacity.

14 For these reasons, we decline to adopt RUCO's proposal to adjust Far West's plant in service
 15 for excess capacity.

16 Working Capital

17 During the course of the proceeding, Far West, Staff, and RUCO came to agreement
 18 regarding the methodology for calculating working capital, and their differing recommendations for a
 19 working capital allowance are based only on their respective positions regarding the disputed rate
 20 base issues. Given the findings described above, we find that Far West is entitled to working capital
 21 in the amount of \$1,440,888.

22 Summary of Rate Base Adjustments

23 Based on the foregoing discussion, we adopt and adjusted OCRB and FVRB of \$19,983,089
 24 for Far West in this proceeding.

	<u>Commission Approved</u>
25 <u>OCRB</u>	
26 Gross Plant in Service	\$34,389,224
27 Less: Accumulated Depreciation	<u>4,810,783</u>
28 Net Plant in Service	\$29,578,441

Deductions:

1	AIAC	\$10,192,451
2	CIAC	1,726,854
3	Accum. Amort. of CIAC	<u>(909,423)</u>
4	Net CIAC	\$817,431

5	Customer Security Deposits	\$26,359
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Additions:

6	Allowance for Working Capital	<u>\$1,440,888</u>
7	Total OCRB	\$19,983,089

IV. INCOME STATEMENT

9 Over the course of the proceeding, the parties presenting revenue requirement proposals (*i.e.*,
10 Far West, Staff, and RUCO) came to agreement on all income statement issues. Therefore, the only
11 remaining income statement issues relate to interest, depreciation, property tax, and income tax
12 expenses – all of which flow from the parties' respective positions regarding rate base and cost of
13 capital positions. However, the parties do not disagree on the methodology that should be used to
14 calculate these expense adjustments. Based on our findings herein, we find Far West's adjusted test
15 year operating expenses to be \$2,830,455, which based on adjusted test year revenues of \$2,231,115,
16 results in test year adjusted operating income of (\$599,341).

V. COST OF CAPITAL

18 Far West proposes that the Commission determine its cost of/return on common equity
19 ("COE" or "ROE") to be 10.0 percent, with an overall weighted average cost of capital ("WACC") of
20 7.40 percent. Staff also recommends adoption of a 10.0 percent COE and WACC of 7.40 percent.
21 RUCO proposes adoption of a 9.25 percent ROE and 7.24 percent WACC.

Capital Structure

23 Although Staff and the Company initially disagreed regarding certain amounts of short-term
24 and long-term debt in Far West's capital structure, all presenting a cost of capital analysis eventually
25 agreed to a capital structure comprised of 20.8 percent equity and 79.2 percent debt, with the debt
26 component of the capital structure being comprised of 74.23 percent long-term debt and 4.95 percent
27 short-term debt. (Co. Final Sched. RLJ D-1; Staff Final Sched. JAC-10; RUCO Final Sched. WAR-

1 1.)

2 **Cost of Debt**

3 The parties are also in agreement regarding the Company's overall cost of debt of 6.7 percent,
4 based on a cost of long-term debt of 6.66 percent and a cost of short-term debt of 7.51 percent. (*Id.*)
5 Although Staff and the Company ultimately reached agreement regarding the capital structure and
6 cost of debt, Staff witness Cassidy emphasized that Staff's decision to recommend allowance of
7 short-term debt it had initially rejected does not mean that it agreed with the Company's request to
8 recover short-term debt obligations associated with funding a liability owed to ADEQ and for legal
9 services related to an action taken by ADEQ against Far West, for which the Company sought
10 recovery of at a rate of 12 percent. (Ex. S-4, at 2-3.) Mr. Cassidy stated that it would be unfair for
11 ratepayers to be burdened with costs related to ADEQ violations, but that removing these short-term
12 debt obligations would have resulted in a higher equity component, and thus a higher overall revenue
13 requirement. (*Id.*) Therefore, Staff assigned a cost of 7.4 percent to this short-term debt, which is
14 equal to Staff's recommended WACC, in order to hold ratepayers harmless for debt incurred by Far
15 West in dealing with ADEQ violations. (*Id.*)

16 **Cost of Equity**

17 Far West

18 In determining its proposed cost of common equity in this case, Far West relied on an analysis
19 of costs of equity granted by the Commission in 2012 for several Class A, B, and C water utilities.
20 Based on this review, Mr. Jones concluded that an 11.00 return on equity was the minimum return on
21 equity that is appropriate based on Far West's capital structure and financial risk profile. (Ex. A-1, at
22 16-17.) He claimed that the Company's leveraged capital structure and higher than average financial
23 risk indicate the need for a higher COE compared to other less leveraged companies. (*Id.*) Mr. Jones
24 pointed out that Far West's cash flow was negative during the test year, and will remain negative
25 until the rates from this case go into effect. He added that Far West's deteriorating financial
26 condition could have justified a significant financial risk adjustment; however, he proposed a COE of
27 10.0 percent "considering the magnitude of this rate request, in order to somewhat mitigate the
28 impact of this request and eliminate contested issues." (*Id.* at 16.)

1 Mr. Jones indicated that although he did not agree with the methodology used by Staff in
 2 determining Far West's ROE, he did not raise those concerns because Staff ultimately recommended
 3 a COE of 10.0 percent. (Ex. A-2, at 24.) However, Far West claims that RUCO's 9.25 percent ROE
 4 proposal fails to properly adjust for the Company's significant degree of leverage. (*Id.*) Mr. Jones
 5 asserts that the companies in RUCO's proxy group are all far larger and much less risky than Far
 6 West; RUCO relies on a methodology that the Commission has regularly rejected; it is questionable
 7 whether Far West satisfies the requirements for applying a discounted cash flow ("DCF")
 8 methodology since it does not generate retained earnings or pay dividends; and RUCO's capital asset
 9 pricing methodology ("CAPM") analysis uses the geometric mean of total returns rather than the
 10 more commonly used arithmetic mean. (*Id.* at 24-25.)⁷

11 RUCO

12 RUCO proposes adoption of a 9.25 percent COE based on Mr. Rigsby's DCF and CAPM
 13 analyses.⁸ For his DCF analysis, Mr. Rigsby employed two proxy groups of companies, one
 14 comprised of a group of publicly traded water companies, and the other of publicly traded natural gas
 15 local distribution companies ("LDCs"). His DCF analysis, as updated in his surrebuttal testimony,
 16 produced a COE for the water group of 8.44 percent and a COE of 8.74 percent for the gas LDCs.
 17 (Ex. R-24, at 6.) Mr. Rigsby's CAPM analysis, as updated in his surrebuttal schedules, resulted in an
 18 average expected return of 5.99 percent for the water company proxy group and an average expected
 19 return of 5.83 percent for the natural gas LDCs, using a geometric mean to calculate the risk
 20 premium. (Ex. R-23, at 36; Ex. R-24, Sched. WAR-1.) Using an arithmetic mean resulted in average
 21 expected returns of 7.11 percent and 6.89 percent, respectively, for the water and gas proxy groups.

22 _____
 23 ⁷ In its initial brief, Far West included tables purporting to represent recent returns on equity, costs of debt, and WACCs
 24 granted by the Commission to various companies, as well as arguments based on that information. (Co. Initial Brief at 13-
 25 16.) RUCO argued in its reply brief that the Commission should strike that portion of the Company's brief because it
 26 presented new evidence not introduced at the hearing and would therefore constitute a denial of due process if relied upon
 27 by the Commission in rendering a decision. (RUCO Reply Brief at 10-11.) Although we do not agree with RUCO that
 28 the information cited by Far West would result in a denial of due process, given that the tables simply provide a recitation
 of ROEs, costs of debt, and WACCs approved by the Commission (and for which the Commission could justifiably take
 official notice), we will not rely on the information cited by the Company in those tables for purposes of this Decision.

⁸ As defined by Mr. Rigsby, the DCF is a stock valuation model that is "based on the premise that the current price of a
 given share of common stock is determined by the present value of all of the future cash flows that will be generated by
 that share of common stock." (Ex. R-23, at 8.) The CAPM is a mathematical tool that "is used to analyze the
 relationships between rates of return on various assets and risk as measured by beta." (*Id.* at 29-30.) "Beta" is "an index
 of volatility, or risk, in the return of an asset relative to the return of a market portfolio of assets." (*Id.* at 30.)

1 (*Id.*)

2 As calculated by Mr. Rigsby, the average of his DCF results is 8.59 percent; the average of
3 his CAPM results is 6.46 percent; and the average of both the DCF and CAPM methodologies is 7.52
4 percent. (*Id.*) After considering a number of factors, including the current state of the economy,
5 current rates of unemployment, and the Federal Reserve's actions regarding interest rates, Mr. Rigsby
6 concluded that a ROE of 9.25 percent would provide Far West a reasonable return on invested equity
7 capital. (Ex. R-23, at 54.) He pointed out that RUCO's 9.25 percent ROE proposal is 51 basis points
8 higher than the updated DCF results for the gas LDC proxy group, and 81 basis points higher than the
9 updated water company DCF results. (Ex. R-24, at 6.)

10 Staff

11 Staff recommended that the Commission approve a COE for Far West of 10.0 percent based
12 on Staff's use of DCF and CAPM analyses. As set forth in his surrebuttal testimony, Mr. Cassidy
13 determined a COE of 8.5 percent based on an average of his 8.7 percent DCF result and 8.3 percent
14 CAPM outcome. (Ex. S-4, at 4.) In addition, Staff recommended a 60 basis point (0.6 percent)
15 upward "economic assessment" adjustment to Far West's COE, as well as a 90 basis point (0.9
16 percent) upward "financial risk" adjustment. These adjustments of 150 basis points to Staff's
17 baseline COE result of 8.5 percent result in Staff's overall recommendation of a 10.0 ROE for Far
18 West in this proceeding. (*Id.* at 5.)

19 Mr. Cassidy stated that the financial risk adjustment was necessary, from a cost of capital
20 perspective, to recognize the Company's highly leveraged capital structure. (Tr. 735-736.) The
21 economic assessment adjustment is intended to reflect the "totality of uncertainty" in a broader sense,
22 based on economic conditions nationally and internationally. (*Id.* at 738-740.)

23 Conclusion

24 After reviewing all of the evidence presented in this case, we believe that a ROE of 9.50
25 percent is reasonable for Far West. We understand that, from a cost of capital perspective, Far
26 West's highly leveraged capital structure creates a degree of financial risk, and that in a broader
27 economic sense it may be appropriate to afford some recognition to uncertainties that exist in the
28 national and global economies in establishing ROE. We understand the rationale and analyses

1 offered by the Company and Staff regarding the relative riskiness inherent in an equity investment in
2 a highly leveraged company such as Far West and, under normal circumstances, we believe that a
3 ROE in the range of 10.0 percent could be justified for Far West.

4 At the same time, however, we must recognize that, as will be further discussed below, the
5 actions of Far West's management are contributing factors to its financial instability and history of
6 non-compliance with regulatory requirements. Although it appears that the Company has made
7 progress in dealing with numerous ADEQ violations, Far West has failed to timely pay numerous
8 vendors for services and materials; failed to timely pay developers amounts owed under MXAs,
9 including Spartan Homes, which the Company was explicitly ordered to pay in Decision No. 72594
10 as a result of a formal complaint filed by Spartan; failed to timely pay property taxes to Yuma
11 County; failed to amounts owed by affiliate entities; engaged in transactions with affiliate companies
12 without written agreements or through unbid contracts; failed to comply with a number of prior
13 Commission directives and ADEQ Consent Orders; and has been generally unable, at times, to
14 manage its operations in a manner expected and required of a public service corporation operating in
15 this state.

16 The oft-cited *Hope* and *Bluefield* cases,⁹ require that a regulated utility company should be
17 provided with rates that will allow it an opportunity to earn a return that is comparable to those of
18 similarly situated enterprises. (*See, e.g.*, Decision No. 71308, at 48.) However, implicit in the
19 regulatory compact of setting just and reasonable rates for a given company is the assumption that the
20 company is well managed and operationally efficient. For Far West, the historical record of its
21 operations indicates that it has been poorly managed and operated for a number of years, as
22 evidenced by, among other things, numerous unpaid obligations, a number of ADEQ NOVs, failure
23 to document through written contracts agreements with affiliated entities, and a patent disregard of
24 prior Commission Orders. We believe the Company should be accountable for its actions, and that a
25 downward adjustment to the ROE that might otherwise be justified is an appropriate means of taking
26 those actions into account.

27 _____
28 ⁹ *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Bluefield Waterworks & Improvement Co. v. Public Serv. Comm'n of West Virginia*, 262 U.S. 679 (1923).

1 We therefore find that the 10.0 percent ROE recommendations made by the Company and
2 Staff should be reduced by 50 basis points, to 9.50 percent, to recognize management's role in the
3 Company's unstable financial condition, operational problems, and regulatory non-compliance.

4 **Cost of Capital Summary**

	<u>Weight</u>	<u>Cost</u>	<u>Weighted Avg. Cost</u>
6 Common Equity	20.82%	9.50%	1.98%
7 Short-Term Debt	4.95%	7.51%	0.37%
8 Long-Term Debt	74.23%	6.66%	<u>4.94%</u>
9 Weighted Avg. Cost of Capital			7.29%

10 **VI. AUTHORIZED REVENUE INCREASE**

11 Based on the discussion herein, the authorized total revenue increase is \$3,415,622.

12 Fair Value Rate Base	\$19,983,089
13 Required Fair Value Rate of Return	7.29%
14 Required Operating Income	\$1,456,767
15 Adjusted Operating Income (Loss)	(599,341)
16 Operating Income Deficiency	2,056,108
Gross Revenue Conversion Factor	<u>1.6612</u>
Gross Revenue Increase	\$3,415,622

17 **VII. RATE DESIGN**

18 All parties to the proceeding are proposing the same rate structure consisting of a flat
19 wastewater rate for residential customers, and a flat rate according to meter size for commercial
20 customers. The parties are also in general agreement regarding the RV rate structure, which consists
21 of a flat rate for common facilities plus a flat rate for each RV space. The Company and Staff are
22 also in agreement regarding the applicable effluent rate and commercial meter multipliers. (Ex. A-8;
23 Tr. 1045-47.)

24 RUCO is also in agreement with the Company with the exception of a small difference in
25 commercial meter multipliers and the effluent rate. RUCO proposes to index commercial meter
26 multipliers starting with the 5/8-inch commercial meter customers, whereas the Company and Staff
27 index the commercial meter multipliers beginning with the residential customer rate. (Ex. R-21; Tr.
28 1047.) RUCO claims that its proposal places greater revenue recovery responsibility on the

1 commercial customers to recognize RUCO's contention that "higher metered customers have not
2 historically paid [rates] proportionate to their use." (RUCO Initial Brief at 17.) We do not find any
3 valid basis for adopting RUCO's meter multiplier proposal as it appears to be based solely on
4 RUCO's desire to shift revenue recovery from residential to commercial customers. We will
5 therefore adopt the multipliers agreed to by Far West and Staff at the hearing.

6 With respect to the effluent rate, the Company and Staff came to an agreement during the
7 hearing that the rate should be reduced from the current \$1.00 per thousand gallons to the greater of
8 \$0.25 per thousand gallons or the local market rate, in recognition of the ability of effluent customers
9 to pump groundwater for irrigation purposes. (Ex. A-1, at 18; Ex. A-8.) Although RUCO did not
10 address this issue in its brief, its final schedules show that RUCO proposes to maintain the effluent
11 rate at its current level. (RUCO Final Sched. TJC-RD 1.) We believe the Company has demonstrated
12 that a downward adjustment to the effluent rate is justified due to the unrestricted ability of effluent
13 customers to pump groundwater at a much lower cost than the current rate. In addition, enabling Far
14 West to continue to sell effluent at a market level rate will avoid placing the cost of disposal on the
15 Company in the event no customers are interested in buying effluent at the current rate.

16 **Rate Increase Conditions**

17 On the fourth day of the hearing, the Company and Staff presented a document titled "Rate
18 Increase Conditions" that sets forth a number of terms that Far West has now agreed to as a condition
19 of implementation of rates. The nine rate conditions are as follows:

- 20
21 1. ADEQ Compliance. Any increase in rates and charges approved in this proceeding shall not become effective until Far West files documentation from ADEQ that Far West's wastewater treatment plants are in compliance with ADEQ's Consent Judgment as it may be amended.
- 22
23 2. Spartan Homes. Any increase in rates and charges approved in this proceeding shall not become effective until Far West makes the payments and files the CC&N extension required by Decision No. 72594.
- 24
25 3. Rate Phase-In. Any new rates approved in this proceeding will be phased in with 50 percent of the increase coming effective for bills rendered on or after the first day of the month after the Company achieves compliance with both Conditions Nos. 1 and 2, above, with the remaining 50 percent becoming effective six months later. There will be no recovery of lost revenue or interest associated with the phase-in period.
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- 4. Property Taxes. Far West shall submit a payment plan for the full payment of all delinquent property taxes and penalties for years 2008, 2009, 2010, 2011, and 2012 that is acceptable to Yuma County for Staff review and Commission approval in this docket.
- 5. MXAs. Far West will make monthly payments to developers for unpaid amounts due under Main Extension Agreements ["MXAs"] with the condition that all amounts due be fully paid not later than June 30, 2015.
- 6. Collections from Related Parties. Far West will collect all amounts owed by related parties no later than 12 months from the date when Phase I of new rates are effective in this proceeding, or December 31, 2014, whichever is sooner.
- 7. Effluent Rates. Effluent rates should be set at a rate equal to or the greater of \$0.25 per thousand gallons or local market rate.
- 8. RV Tariff Language. The following language should be added to Far West's tariff:
 - 1. *The RV Rate shall apply only to a parcel of land under single ownership on which three (3) or more Recreational Vehicles are occupied as temporary residents, regardless of whether or not a charge is collected for such accommodations (RV Park).*
 - 2. *A Recreational Vehicle is a vehicle that is built on a single chassis, four hundred (400) square feet or less in size, designed to be self-propelled (motor home) or permanently towed (trailer, fifth wheel, or camper), and designed primarily for use as temporary living quarters for recreational, camping, travel, or seasonal use and not for use as a permanent dwelling. A Recreational Vehicle includes park model trailers, provided that they have not been altered to increase living space beyond 400 square feet. Recreational Vehicles do not include Manufactured Homes (a/k/a Mobile Homes).*
 - 3. *Each RV Park shall be assessed a single base charge for the sewer usage at clubhouses, laundries and other common areas. In addition, a fee shall be paid for each RV Park space whether occupied or not.*
 - 4. *Combined facilities that include both an RV Park and Manufactured Home Park shall pay the RV Park rate for the RV Park portion of the facility with the residential tariff applying to the Manufactured Home spaces within the facility.*
- 9. Affiliate Transaction Policy. Far West will formulate and adopt a formal written policy concerning affiliate transactions. The policy will address the specific steps that Far West will take to demonstrate that the transactions between Far West and its affiliates and related parties are arms-length, transparent and well documented. Further, the policies will include a competitive bidding process and require that Far West maintain evidence of competitive biddings for all major construction projects. Far West will submit such a policy for Staff's review and approval.

Staff also proposed a tenth term that it believes should be imposed as a condition of Far West

1 receiving rate relief in this case. (Ex. S-10; Tr. 792-800.) The additional condition is as follows:

2 While Staff does not recommend the appointment of an interim
3 manager at this time because the Company has made significant
4 progress, some necessary improvements remain. Staff believes if the
5 Company fails to satisfy the rate increase conditions set forth in Exhibit
6 A-8, Staff is requesting the authorization, in this case, to appoint an
7 interim manager.

8 According to Staff witness Becker, Staff is recommending that it be given authorization in
9 this case to appoint an interim manager in the event the Company fails to comply with the nine
10 agreed upon conditions, without further action of the Commission. (Tr. 845.) The Company is in
11 agreement with the first nine conditions, but does not agree to the tenth condition regarding
12 Commission authorization in this case for Staff to appoint an interim manager in the event Far West
13 fails to comply with the first nine conditions. (Tr. 1049-50.)

14 We believe the conditions proposed by Staff and the Company, as well as the tenth condition
15 advocated by Staff are reasonable and should be adopted, subject to the modifications discussed
16 below.

17 ADEQ Compliance

18 We agree with the condition that the rates established in this proceeding should not become
19 effective until Far West has filed written documentation from ADEQ showing that the Company has
20 satisfied fully the terms of all current Consent Orders with ADEQ, and any other remaining ADEQ
21 compliance issues. The Company may put the authorized rates into effect on the first day of the
22 month following the filing of such documentation in a form that is acceptable to Staff.

23 Spartan Homes

24 The issues raised by Spartan Homes are addressed below in more detail; however, we agree
25 that Far West should be required to satisfy fully all outstanding payments due to Spartan Homes as
26 ordered in Decision No. 72594. The Company may put the authorized rates into effect on the first
27 day of the month following the filing of such documentation in a form that is acceptable to Staff.¹⁰

28 ¹⁰ We note that the second part of this condition has been satisfied by Far West's filing, on July 15, 2013, of a CC&N extension application in Docket No. WS-03478A-13-0250. However, Staff filed an Insufficiency Letter on August 14, 2013 setting forth the additional documentation and information needed by Staff to move forward with the CC&N application.

1 Rate Phase-In

2 We believe that it is reasonable, given the magnitude of the requested increase, to phase-in the
3 rates authorized in this case in two parts. Therefore, Far West will be required to implement 50
4 percent of the established rates upon satisfaction of the conditions as discussed herein, with the full
5 rate increase becoming effective six months thereafter. Notice of both phases of rates shall be given
6 to customers prior to the effectiveness in a form acceptable to Staff. Notice of the second rate phase
7 increase shall be given within 30 days prior to those rates being implemented. Far West will not be
8 entitled to recover any lost revenue or interest associated with the rate phase-in, in accordance with
9 the agreement in Exhibit A-8.

10 Property Taxes

11 We agree that Far West should be required to submit documentation of a payment plan with
12 Yuma County for payment of all delinquent property taxes and penalties. Documentation must be
13 filed showing written agreement by the County to the payment plan, and we will require this
14 agreement to be filed prior to the rates in this case becoming effective. The Company may put the
15 authorized rates into effect on the first day of the month following the filing of such documentation in
16 a form that is acceptable to Staff.

17 MXAs

18 Given the past failure of Far West to pay amounts required and due under MXAs to
19 developers, we agree that the Company should be required to make arrangements to make monthly
20 payments to developers and that all amounts due should be paid fully by no later than June 30, 2015.
21 We will also require, prior to the rates in this case becoming effective, that Far West file
22 documentation showing a full accounting of all developers owed money under MXAs, the amounts
23 owed to each entity, and a detailed plan of the monthly amounts to be paid to each developer that will
24 enable all MXA amounts to become current by no later than June 30, 2015. The Company may put
25 the authorized rates into effect on the first day of the month following the filing of such
26 documentation in a form that is acceptable to Staff. In addition, Far West should file every 180 days
27 following the effective date of the rates in this case, until paid in full, a ledger or other documentation
28 showing all amounts paid to developers in compliance with its MXA payment plan.

1 Collections from Related Parties

2 We agree that Far West should be required to collect all amounts owed by related or affiliated
3 entities to the Company (*i.e.*, any companies or entities with common ownership or control) by the
4 earlier of 12 months from the effective date of the Phase 1 rates or December 31, 2014. We will also
5 require, prior to the rates in this case becoming effective, that Far West file documentation showing a
6 full accounting of the related/affiliated entities that owe Far West money, the amounts owed by each
7 entity, and a detailed plan of the monthly amounts to be paid by each entity that will enable all
8 amounts due to become current by the earlier of 12 months from the effective date of Phase 1 rates or
9 December 31, 2014. The Company may put the authorized rates into effect on the first day of the
10 month following the filing of such documentation in a form that is acceptable to Staff. In addition,
11 Far West should file every 180 days following the effective date of the rates in this case, until paid in
12 full, a ledger or other documentation showing all amounts paid by related/affiliated entities in
13 compliance with the proposed payment plan.

14 Effluent Rates

15 As discussed above, effluent rates should be charged by Far West at the greater of \$0.25 per
16 thousand gallons or local market rates.

17 RV Tariff Language

18 As discussed above, the RV tariff language agreed to by the parties should be incorporated
19 into Far West's rates in compliance with this Decision, prior to the rates becoming effective.

20 Affiliate Transaction Policy

21 We agree that Far West should be required to develop and adopt a formal written transaction
22 policy consistent with Condition No. 9 in Exhibit A-8. The Company shall be required to file the
23 affiliate transaction policy within 30 days of the effective date of Phase 1 rates, and shall be subject to
24 Staff's review and shall be modified as may be deemed necessary by Staff.

25 Interim Manager

26 We agree with Staff that given Far West's history of non-compliance with Commission
27 Orders, it is appropriate in this case to grant Staff the authority, without further action of the
28 Commission, to appoint an interim manager if the Company fails to comply with the modified

1 conditions discussed above.

2 **Approved Rates and Charges**

3 Based on the foregoing discussion, and subject to Far West's compliance with the
 4 requirements set forth above, the rates and charges for residential and commercial wastewater service
 5 shown in Attachment 1 are approved. As shown in Attachment 2, residential customers will
 6 experience a Phase 1 increase of \$17.55 per month, from the current \$21.75 to \$39.30, or 80.69
 7 percent. Six months following the effective date of the Phase 1 rates, the full rate increase will take
 8 effect, and the residential wastewater rate will increase to \$57.41 per month, a total dollar increase
 9 over current rates of \$35.66, or 163.95 percent. (*See* Attachment 2.)

10 **VIII. INTERVENOR ISSUES**

11 The "Intervenors" (*i.e.*, the Gilkeys and Mr. Rist) are seeking the following actions by the
 12 Commission in this case: requiring the Company to file a hook-up fee application and including the
 13 Gilkeys and Mr. Rist as intervenors in that docket;¹¹ prohibiting the Company from issuing any
 14 capacity assurances until a hook-up fee is approved; installing an interim manager; ordering a
 15 forensic audit of Far West's books and records; requiring appointment of an independent board of
 16 directors; and "bring[ing] the record from this case is (sic) forward to any future Far West rate case."
 17 (Gilkey/Rist Initial Brief at 7-10.)

18 The other intervenor, Spartan Homes, requests that the Commission make any rate increase
 19 authorized in this case contingent on: Far West first demonstrating compliance with all statutes, rules
 20 and decisions of the Commission; Far West first demonstrating that it is current on all refunds of
 21 advances in aid of construction for water and wastewater; setting a deadline for adoption of a formal
 22 affiliate transaction policy; and collecting all amounts due from related parties, as set forth in
 23 Condition No. 6 of Exhibit A-8. (Spartan Homes Initial Brief at 2-4.)

24 Before discussing the issues raised by the Intervenors and Spartan Homes, we believe it is
 25 useful to provide an overview of Far West's operational and regulatory background.

26 ...

27 _____
 28 ¹¹ On June 19, 2013, Far West filed an application for approval of water and wastewater hook-up fees in Docket No. WS-03478A-13-0200.

1 **Company Background and Regulatory History**

2 Far West's current wastewater system is comprised of a collection system with 16 lift stations
3 and 6 wastewater treatment plants: the Marwood WWTP; Section 14 WWTP; MDS-Del Oro WWTP;
4 Seasons WWTP; Del Ray WWTP; and Villa Royale WWTP. (Ex. A-1, at RLJ-DT2, Sched. E.)
5 According to Company witness Jones, the Company's wastewater system historically was made up of
6 small isolated collection and treatment systems serving individual subdivisions or developments, and
7 with rapid growth from the late 1990s through the mid-2000s the facilities were unable to keep up
8 with the growth and environmental regulations. (*Id.* at 4.)

9 **Decision No. 71447**

10 On August 29, 2008, Far West filed a permanent rate application seeking a revenue increase
11 of approximately 215 percent (Docket No. WS-03478A-08-0454). While the permanent rate
12 application was being processed, the Company filed, on December 19, 2008, an emergency
13 application for an interim rate increase of approximately 100 percent (Docket No. WS-03478A-08-
14 0608). The permanent rate case was then suspended while the emergency rate case was being
15 considered, by Procedural Order issued January 26, 2009.

16 Hearings were conducted in April and May of 2009 in the emergency case and, on December
17 23, 2009, the Commission issued Decision No. 71447 denying Far West's application for interim rate
18 relief. It is useful to recount Far West's history of regulatory and compliance problems, as described
19 in Decision No. 71447, to provide context to the current rate application and the issues facing the
20 Company. As set forth in that Decision, ADEQ investigated Far West's sewer operations following
21 customer complaints about odors and effluent quality. On March 10, 2006, ADEQ entered into a
22 Consent Order with Far West with respect to the Del Oro treatment facility. In that Consent Order,
23 Far West was required to take short, medium and long-term measures to address operational,
24 maintenance, capacity and permitting deficiencies associated with the Del Oro plant. (Decision No.
25 71447, at 3-4.)

26 In April 2006, after the Del Oro Consent Order, Far West hired Coriolis, an engineering firm,
27 to perform a "comprehensive review of the entire utility, water and sewer" including addressing the
28 issues of the wastewater plants. Far West claimed that before Coriolis could prepare a comprehensive

1 engineering study, the Company had to address the issues surrounding the Del Oro treatment plant.
2 Far West asserted it needed to find a way to treat approximately 300,000 gpd at the Del Oro Plant,
3 and with the assistance of Coriolis, was able to locate a temporary treatment facility. Far West
4 installed the temporary plant at the Del Oro location and placed it in operation prior to the deadline in
5 the ADEQ Consent Order, and then turned to solving a system-wide odor problem, which resulted in
6 the Company injecting bioxide chemicals throughout the system and installing carbon filters. (*Id.* at
7 4.)

8 In the course of its analysis, Coriolis found that Far West had many more issues besides the
9 Del Oro Treatment Plant, including issues facing the water division. After addressing the deficiencies
10 at the Del Oro Plant and the odor problems, the Company claimed it then proceeded to address
11 longer-term goals of designing a water and wastewater system, which would allow the Company to
12 “get ahead of the curve.” Because the Company did not have proper plant inventories or maps of its
13 systems, and had a hard time locating facilities for repair and maintenance and keeping track of
14 customers, Coriolis recommended that Far West engage in a mapping project and purchase new
15 billing software. (*Id.* at 4-5.)

16 As described in Decision No. 71447, Coriolis determined that all of Far West’s wastewater
17 plants, except the Marwood plant, required major modifications. The engineers indicated that Far
18 West had too many treatment plants for the size of its service area, which the Company contended
19 was the result of rapid development, with individual developers building only the plant capacity that
20 they needed for their individual developments and then contributing the plant to Far West. In
21 addition, according to Decision No. 71447, the treatment systems were not working properly and
22 could not easily be made to work properly. Problems with the wastewater treatment plants included
23 inadequate aeration in the tanks, and inadequate mechanisms for handling sludge and removing
24 effluent. As a result, Far West’s treatment plants were not meeting the applicable nitrogen
25 requirements and were sometimes exceeding turbidity and fecal coliform limits. (*Id.* at 5.)

26 Decision No. 71447 states that Coriolis designed a sewer renovation project which involved
27 expanding the Section 14 plant, from a capacity of 150,000 gpd to 1.3 million gpd, closing the Palm
28 Shadows plant and diverting the flows that had been going to Palm Shadows to Section 14 for

1 treatment. The Palm Shadows plant would then be decommissioned and converted to a lift station.
2 The Del Oro plant would be expanded from a capacity of 300,000 gpd to 495,000 gpd, and the Villa
3 Del Rey and Villa Royale flows would be diverted to the new Del Oro plant, and the Villa Del Rey
4 and Villa Royale plants would be closed. The temporary plant installed at Del Oro would be moved
5 to the Seasons plant, which would expand its capacity from 70,000 gpd to 150,000 gpd. In addition,
6 some of the flows currently treated at the Marwood plant would also be diverted to the Section 14
7 Plant. (*Id.*)

8 In July 2006, the Company obtained the first of two bridge anticipation notes ("BANs"). The
9 first BAN, was in the amount of \$11.1 million, and was secured by the pledge of the shareholders'
10 stock in Far West. The purpose of the first BAN was to allow Far West to begin funding the costs of
11 the system-wide improvements, including design and engineering costs. (*Id.* at 5-6.)

12 On October 25, 2006, Far West entered into a second Consent Order with ADEQ, which order
13 superseded the first. The new Consent Order required Far West to apply for new or amended APPs
14 for the Del Oro, Seasons and Section 14 plants, as well as closure permits for the Villa Royale, Villa
15 Del Rey and Palm Shadows plants. The Company was required to submit APP applications relating
16 to those projects within 30 to 90 days. The Company met the deadlines for the submissions. (*Id.* at
17 6.)

18 On December 31, 2006, Far West closed on a second BAN for \$17.7 million, which was
19 secured by a pledge of the shareholders' stock. The purpose of the second BAN was to pay off the
20 first BAN and provide additional funds to cover the costs of the ongoing water and sewer system
21 renovation. Far West stated that Coriolis' goal was to complete its work for Far West by February
22 2007. Far West's shareholders used the BANs to continue the procurement process and begin
23 construction. Far West determined that it would order plant prior to receiving ADEQ approval of the
24 APPs. Decision No. 71447 indicates that the Company believed that it could start ordering
25 equipment, as long as it did not hook it up until after it received the APP approvals from ADEQ. (*Id.*)

26 In the Second Consent Order, ADEQ directed Far West to cease all construction-related
27 activities, including procuring equipment until the APPs were issued. Far West claimed that it tried
28 to convince ADEQ to allow it to proceed at its own risk with construction activities, but ADEQ

1 would not agree, and all construction and most procurement activities stopped until ADEQ issued the
2 APPs. Far West stated that it took ADEQ 18 months to issue all of the permits. (*Id.*)

3 During the period ADEQ had the APPs under review, Far West claimed that it undertook
4 activities that did not require ADEQ permits, such as preparing sites for the renovation projects and
5 preparing the long-range engineering study. Far West also sought permanent financing for the
6 system improvements. The Company obtained a commitment for the issuance of Industrial
7 Development Authority (“IDA”) bonds through the Yuma County IDA in the amount of \$32.5
8 million. The projects included in the request included “the acquisition, construction and installation
9 of improvements to Far West’s wastewater treatment plants and drinking water treatment system.”
10 (*Id.* at 6-7.)

11 The IDA financing required Commission approval and, on July 26, 2007, Far West filed a
12 Financing Application with the Commission. According to Decision No. 71447, Far West concluded
13 that under its existing rates it might not be able to support a Financing Application with the
14 Commission for the entire \$32.5 million, and thus, reduced its IDA funding request to a little more
15 than \$25 million. The \$25 million was intended to allow Far West to pay off an existing WIFA loan
16 in the amount of \$4.45 million (as required by the IDA bondholders), pay off the second BAN and
17 construct the sewer system upgrades once ADEQ approved the APPs. Far West’s Financing
18 Application sought authority to “(1) issue evidence of indebtedness in an amount not to exceed
19 \$25,215,000 . . . for the purpose of constructing sewer system infrastructure improvement needed to
20 ensure safe and reliable utility service and comply with the two Consent Orders between the
21 Company and [ADEQ] and for the repayment and consolidation of certain existing debt, which was
22 incurred by the Company on a short-term basis for similar purposes.” On October 30, 2007, in
23 Decision No. 69950, the Commission authorized Far West to obtain the IDA financing. (*Id.* at 7.)

24 Decision No. 71447 also states that, in filing its Financing Application with the Commission,
25 the Company indicated that a portion of the IDA funds would be used to repay and consolidate the
26 outstanding debt, which debt had been used in part for water system improvements. Far West
27 claimed that by the time the IDA funds were taken down, the Company had already spent nearly \$1
28 million to improve its water system, and had committed to spend roughly \$1.8 million on water

1 system related improvements. Far West stated that it inadvertently omitted requesting authority to
2 finance improvements to the water system, as well as the sewer projects falling outside those
3 improvements strictly necessary to comply with the Consent Order, when it requested financing
4 authority from the Commission. It claimed that the omission was an oversight. (*Id.* at 7-8.)

5 Decision No. 71447 observed that, by mid-2007, the effluent ponds at the Palm Shadows
6 plant had ceased to percolate, and the Company began to incur the costs of hauling effluent from the
7 Palm Shadows treatment plant to City of Yuma facilities. Far West utilized its affiliate, H&S
8 Developers, a real estate development company, owned by the principals of Far West, to deliver the
9 effluent from the Palm Shadows plant to the City of Yuma for disposal at a monthly cost of
10 approximately \$45,000, including the costs paid to the City. Far West claimed that by using H&S
11 Developers, it was able to reduce its costs of hauling this effluent. (*Id.* at 8.)

12 In August 2008, ADEQ issued the last of the APPs and other approvals necessary for Far
13 West to proceed with its wastewater treatment plant renovation project. However, Far West claimed
14 that from the time it obtained the bonds and the time when it was able to bid the project, prices had
15 increased dramatically, including prices for plastic and plastic piping, metals, electronics, and
16 mechanical equipment, and the dollar had also lost significant strength against the Canadian dollar,
17 which increased the cost of the membranes. Far West asserted that additional costs resulted from
18 requirements imposed in the ADEQ permits, including the construction of vadose wells and claimed
19 "cost overruns" over its original estimates of approximately \$4.5 million. (*Id.* at 8-9.)

20 Far West indicated that when it became aware of the amount of increased costs associated
21 with the sewer improvement project, it tried to find additional funds to complete the project and,
22 although it initially received a loan commitment from Wells Fargo Bank for an additional \$5 million,
23 that commitment was later withdrawn after ADEQ announced that it would file a lawsuit against Far
24 West for past violations and a national banking crisis had arisen. In the meantime, the Company
25 asserted that it was incurring costs for equipment and construction and was rapidly depleting the
26 remaining funds available from the IDA financing. (*Id.* at 9.)

27 In the emergency rate application, Far West provided schedules which indicated that as of
28 April 2009, the Company owed: more than \$3.3 million to vendors for equipment and construction of

1 plant associated with the wastewater treatment renovations it stated were necessary to comply with
2 the ADEQ Consent Order; \$100,000 for purchased water to the Yuma Mesa Irrigation District; and
3 \$318,281 to Yuma County for property taxes. (*Id.* at 10.) The Company claimed in that case that it
4 had a projected cash flow shortage in excess of \$6.4 million for 2009, and argued that because it
5 could no longer pay its debts as they come due in the ordinary course of business, it was insolvent.
6 (*Id.*)

7 Far West further asserted in the emergency case that it could not complete the sewer
8 renovations necessary to comply with the Consent Orders, and that project vendors would not finish
9 installation and start-up until they were paid. The Company contended that the shareholders infused
10 \$400,000 in capital to pay critical expenses, but had depleted the shareholders' personal resources;
11 and although they were willing to pledge stock or make personal guaranties, they had not been able to
12 raise either equity or debt in sufficient sums to complete the project. (*Id.* at 10-11.) Far West claimed
13 that Staff's recommendation for an equity infusion from shareholders was unrealistic, because the
14 shareholders did not have any more capital to invest, and securing a private equity placement was
15 highly unlikely given the Company's financial condition. (*Id.* at 14.)

16 Decision No. 71447 found that based on all of its activities, including its construction
17 projects, the Company had not paid its obligations as they came due and, thus, "the Company is
18 insolvent..." (*Id.* at 26.) However, the Commission indicated that although the Company may be
19 insolvent, the unpaid bills were overwhelmingly attributable to the construction project, and that the
20 Company had a positive cash flow from operations. Decision No. 71447 indicated that the
21 emergency rate request was not due to operating expenses increasing so much that the Company
22 could not continue to provide service pending a traditional rate case, and was not a reflection of a
23 sudden change that results in hardship. Rather, the Commission determined that the Company's
24 compliance deficiencies had been an issue for years, and the fact that the final construction budget
25 increased in August 2008 after ADEQ approved the APPs was a foreseeable occurrence resulting
26 from the delay. (*Id.* at 26-27.)

27 In denying the request for emergency rate relief in that case, the Commission expressed
28 concern about the public safety implications of Far West continuing to operate wastewater treatment

1 plants with operational deficiencies, but indicated that it was extraordinary to consider a request to
2 have ratepayers to pay up front to construct utility plant. The Commission also indicated doubt that
3 Far West's management would be able to complete the project or use ratepayer funds to the benefit of
4 the ratepayers. The Commission noted that the Company's projections assumed a continuing pay
5 down of affiliate payables, and that the shareholders claimed to have exhausted their personal ability
6 to contribute equity to Far West, but had not explained or demonstrated whether the Company's
7 affiliates, including H & S Developers, could not and should not act as a source of capital. (*Id.* at 27.)

8 The Commission concluded that the emergency rate case raised concerns about whether Far
9 West's management would be able to manage the completion of the sewer project, and thus directed
10 Staff to investigate and formulate a recommendation to the Commission regarding whether it would
11 be in the public interest to appoint an interim operator for the Company, especially given ADEQ's
12 apparent lack of trust in the Company. (*Id.* at 28.) Decision No. 71447 stated that the Commission
13 had lost confidence in Far West management's ability to complete the sewer construction project and
14 operate the company to the benefit of the ratepayers, because the Company had engaged in many
15 transactions with affiliates and there had not been an adequate investigation into whether the sums
16 paid to affiliates were fair and made at arms-length. (*Id.*) The Commission therefore directed Staff to
17 investigate and recommend whether it would be in the public interest to appoint an interim manager.
18 (*Id.* at 34.)

19 **Interim Manager**

20 Against the background of Decision No. 71447, and especially the substantial concerns
21 expressed in that Decision regarding Far West's management, we turn to the Intervenors' argument
22 that the Commission should appoint an interim manager in this case.

23 The Intervenors contend that an interim manager should be appointed immediately, claiming
24 that Far West has a long history of poor management. They claim that the Company's financial
25 struggles are attributable to poor planning and management, and the use of affiliate companies for
26 labor and materials. (Gilkey/Rist Ex. 2, at 9.) The Intervenors assert that there have been accounting
27 irregularities involving the transfer of funds between affiliate entities, as well as payments for
28 services to a shareholder's spouse, Mr. Capestro, for legal and management services that were not

1 justified. (*Id.* at 10-11.) They argue that the shareholders and management of Far West are not
2 qualified to run the Company, as exemplified by ongoing poor service quality, odors at treatment
3 plants, and sewage spills. (Intervenors' Initial Brief, at 2.) They contend that although the Section 14
4 plant has resolved some of the odor issues, odors continue at the Marwood plant. (*Id.* at 2-3.)

5 With respect to sewage spills, the Intervenors point to Mr. Jones' admission that the Company
6 "would want to have less spills than that" regarding the nine reported spills to ADEQ in 2012, as
7 evidence of poor management and inadequate preventive maintenance. (Tr. 1023.) Regarding the
8 Palm Shadows plant, which was closed due to the failure of retention ponds to adequately percolate
9 into the ground, the Intervenors suggest that its closing after 12 years of operation, and the need to
10 construct a new force main to divert flows from that plant at a cost of more than \$2 million, reflects
11 one of the problems of engaging affiliated companies for construction of facilities. (Intervenors'
12 Initial Brief, at 4.)

13 The Intervenors also argue that there is little transparency in the Company's operations
14 because it is a closely held company, and that Far West has consistently disregarded orders and
15 regulations of the Commission and ADEQ, including the diversion of loan funds for the water
16 division that were restricted to use on wastewater projects to satisfy an ADEQ Consent Order. (*Id.* at
17 4-5.) They Intervenors contend that Far West's dealings with affiliate companies have not been at
18 arms-length, and cite to the Company's payment of \$1.3 million to H&S Developers, on an unbid
19 time and materials basis (Tr. 384), for work on the Palm Shadows force main, as an example of self-
20 dealing that affects ratepayers. The Intervenors argue that the Commission should mandate that the
21 Company institute a formal bid process for major construction projects. (Intervenors' Initial Brief, at
22 5.) Finally, they point to Far West's acquisition of a line of credit from an affiliate, at a 10 percent
23 interest rate, rather than a shareholder equity infusion, as reflective of poor management decisions.
24 (Intervenors' Initial Brief, at 6.)

25 In response to these arguments, Far West contends that the Company "has served its
26 sentence" for prior misdeeds. (Far West Reply Brief, at 2.) According to Far West, it has continued
27 to fulfill its public service obligations despite being denied emergency rate relief even though the
28 Commission deemed the Company's wastewater division to be "insolvent." (Decision No. 71447, at

1 22.) The Company argues that it has been denied a rate increase for four years while at the same time
2 investing millions of dollars in new plant facilities; its books and records have been scrutinized by
3 Staff and RUCO in this case; and it has undergone a thorough independent financial audit in 2009, as
4 well subsequent independent financial reviews for 2010 and 2011. (Tr. 350, 785-787.) Far West
5 asserts that the Intervenors have no financial training and have not offered any evidence that an
6 interim manager could improve the Company's operations or its dire financial condition. (Far West
7 Reply Brief, at 2.)

8 Far West also responded to the Intervenors that: any misdeeds by prior management of the
9 Company are irrelevant; current management is qualified and has performed well under difficult
10 circumstances; and the lack of attendance at the hearings by the Company's shareholders and
11 management is irrelevant because the Company's witness, Ray Jones, was well prepared and
12 knowledgeable regarding all aspects of the case.¹² With respect to service quality allegations made
13 by the Intervenors, the Company points to Staff's investigation and conclusion that there was no
14 evidence to demonstrate violations of quality of service statutes. (Ex. S-2, at 3-4.) Far West further
15 claims that the retirement of the Palm Shadows plant has alleviated most of the prior odor issues, and
16 the remaining odor problems are centered on the Marwood plant, which the Company plans to
17 resolve as soon as possible by constructing a new lift station to reduce flows to that plant. (Tr. 650-
18 651, 1004-1005.)

19 Regarding other claims raised by the Intervenors, Far West asserts that: sewage spills are not
20 at an unusually high level; customers are not being asked to pay for the "failed" Palm Shadows
21 WWTP because the plant was contributed by the developer (Tr. 205); the Company's operations are
22 transparent, as evidenced by its numerous compliance filings and responses to hundreds of data
23 requests in this case; the only hindrance to full regulatory compliance with the Commission and
24 ADEQ is the lack of money; the Company has been trying for two years to obtain the necessary
25 easements to close the Del Rey and Villa Royale WWTPs (Tr. 1040); the Company's affiliate
26 transactions have not harmed customers (Ex. S-8, at 6); shareholders infused more than \$3 million of

27 ¹² In its Reply Brief, Far West also stated that the Capestros were not available at the hearing because Mrs. Capestro
28 underwent surgery in San Diego shortly before the hearing date and was advised not to return to work prior to May 1,
2013. (Far West Reply Brief, at 3.)

1 equity in 2009, and have pledged personal assets for Company debt (Ex. A-2, at 25), but cannot
2 provide additional equity until sometime after new rates are in effect; and Far West has already filed
3 an application for approval of a hook-up fee tariff, as requested by the Intervenors (Docket No. WS-
4 03478A-13-0200). Therefore, Far West argues that there is no valid reason to appoint an interim
5 manager or an independent board of directors.

6 Decision No. 71447 directed Staff to investigate and formulate a recommendation, in this
7 case, as to whether it is in the public interest to appoint an interim manager. In his direct testimony,
8 Staff witness Becker stated that Staff does not recommend appointment of an interim manager, at this
9 time, but requested that the opportunity be reserved for future consideration. (Ex. S-5, at 28.)
10 Following the filing of Commissioner Bitter Smith's letter on March 28, 2013, Staff prepared a
11 Memorandum to supplement the prior testimony, which it filed on April 15, 2013. (Ex. S-9.) Staff's
12 Memorandum stated that "Far West has made significant improvements in its operations that have a
13 direct impact on the health and safety of its ratepayers..." (*Id.* at 1.) Staff cited to the Company's
14 completion of the Section 14 WWTP Phase 1 expansion; the Del Oro WWTP Phase 1 expansion; the
15 closure of the Palm Shadows WWTP and diversion of flows to the Section 14 plant; and ADEQ's
16 indication that it is "encouraged by the progress that Far West has made" in seeking to comply with
17 the ADEQ Consent Order. (*Id.* at 1-2.) Therefore, Staff recommended that no interim manager be
18 appointed "at this time." (*Id.*)

19 As discussed above, Staff and the Company came to an agreement during the course of the
20 hearing on nine conditions that should be imposed on Far West in exchange for being granted rate
21 relief. Staff also recommended that a tenth condition be imposed, to which the Company does not
22 agree, regarding Staff seeking authority in this case to appoint an interim manager without further
23 action by the Commission, if Far West fails to comply with the nine agreed upon conditions. (Exs. A-
24 8 and S-10.)

25 As indicated above, we have adopted all ten conditions with certain modifications, and have
26 thus authorized Staff to seek appointment of an interim manager in the event Far West fails to comply
27 with the nine conditions. We believe granting this authority to Staff will provide a significant
28 incentive to Far West to continue to improve its management decisions and operations and we will,

1 therefore, not direct Staff to seek an interim manager unless the Company fails to comply with the
2 conditions discussed above.

3 **Forensic Audit**

4 The Intervenors also proposed that the Commission order that a “forensic audit”¹³ of the
5 Company be conducted. According to the Intervenors, customers do not have confidence in Far
6 West’s management and its ability to operate the wastewater system in a manner that is compliant
7 with regulations and which provides service at the lowest cost to customers. (Intervenors’ Reply
8 Brief, at 5.) The Intervenors claim that they do not have access to the Company’s financial records,
9 and that Staff and RUCO only reviewed the records that were provided by the Company. The
10 Intervenors state in their brief that they were denied access to commercial water usage information
11 based on privacy concerns (although the information was apparently given to Staff), and it was
12 discovered subsequently that an affiliated fitness center and RV park is connected to the sewer
13 system but had not paid applicable rates. (*Id.* at 4-5.) The Intervenors also assert that certain records
14 were not examined by Staff, including a Schechert Family Trust demand note, a \$200,000 note due to
15 Scott Spencer to cover suspended civil penalties, and two “discrepancies” discovered by the
16 Intervenors in Far West journal entries. (Intervenors’ Initial Brief, at 7-8, citing Tr. 808-816.)

17 Far West contends that there is no justification for ordering a forensic audit because Staff and
18 RUCO thoroughly reviewed the Company’s financial records, including 11 sets of data responses
19 containing thousands of pages of documents (Tr. 785), and Far West supported and justified the
20 expenditures included in this case. The Company asserts that it provided: its general ledger;
21 requested cash disbursement ledgers; and reconciliations that were requested. Mr. Jones testified that
22 Far West underwent a full financial audit in 2009; the Company had two subsequent fully reviewed
23 financial statements; and that “a forensic audit in my opinion is an effort that would be undertaken for
24 a company that simply had no books and records, couldn’t produce a general ledger, couldn’t produce
25

26 ¹³ During the hearing, Staff witness Becker defined a “forensic audit” as “probably the most thorough examination of an
27 organization or individual’s affairs...[and] would include things like mapping out cash flow transactions, the cash receipts
28 and the cash disbursements...identify accounting errors...[and] might enumerate hidden assets, for lack of better
terminology.” (Tr. 815-816.) He added that he has never conducted a forensic audit but he believes they would typically
be done “in criminal proceedings such as when a Ponzi scheme falls apart or when a company goes bankrupt.” (*Id.* at
816.)

1 cash disbursements ledgers, [and] couldn't produce reconciliations that have been requested in this
2 case." (Tr. 350.)

3 With respect to the financial discrepancies cited by the Intervenors, Far West claims that: the
4 \$25,000 disbursement error was corrected (Gilkey Ex. 16), and has no ratemaking impact; the
5 \$12,500 difference between a Form 1099 and a payment made to Mr. Capestro was due to repayment
6 of a previous payment returned to the Company by Mr. Capestro (Gilkey Ex. 14); and the affiliated
7 RV park was not an accounting issue, but rather a disagreement as to the proper rate design for the
8 facility in question which has a mixed-use function. (Ex. A-3, at 8.) Regarding the notes not
9 examined by Staff, the Company contends that further investigation might be justified if there was an
10 entry for a liability with no note support, which is not the case here, and the Schechert Family Trust
11 Demand Note was the subject of extensive discovery and cross-examination at the hearing. (Gilkey
12 Ex. 7; Ex. S-11; Tr. 1051-54.) The Company argues that there is no basis for conducting a forensic
13 audit based on the record in this case.

14 Staff does not believe there is a need for a forensic audit, as proposed by the Intervenors. Mr.
15 Becker testified that Staff performed a "regulatory audit," which he described as an analysis that
16 "aims to provide reasonable assurance that the company's application along with the evidence
17 provided and other information provided...data requests and work papers and so on, supports a
18 company's request for rate relief." (Tr. 816.) He estimated that a forensic audit would likely require
19 the hiring of an outside consultant, with two or three people working for at least three months, with a
20 minimum cost of perhaps \$100,000. (Tr. 841-842.) Mr. Becker added that, to his knowledge, the
21 Commission had never before appointed a forensic auditor of a regulated utility company. (Tr. 846.)
22 He also testified that, based on his review of the application and supporting documents, there were no
23 affiliate transactions that "harmed the ratepayers or caused an excessive burden on the ratepayers"
24 (after taking into account Staff's various recommended disallowances for affiliate payments). (Tr.
25 853-854.)

26 We do not believe that the time and expense of a "forensic audit," as contemplated by the
27 Intervenors, is justified in this case. As indicated by Mr. Jones, Far West's books and records were
28 audited in 2009 by an independent auditor, and subsequent years' financial statements were also

1 independently reviewed. In addition, the Company's books and records were reviewed by both Staff
2 and RUCO, and the Company provided thousands of pages of documents in response to data requests
3 from Staff and intervenors. Moreover, we have disallowed more than \$200,000 of capitalized
4 management fees paid to Mr. Capestro during the test year, in accordance with Staff's
5 recommendation. We also note that through the adoption of Condition No. 9, Far West will be
6 required to develop and file, within 30 days, an affiliate transaction policy that will be subject to
7 Staff's review and modification as may be deemed necessary by Staff, and which should provide
8 some measure of confidence that future affiliate transactions are conducted in an open and arms-
9 length manner.

10 **Spartan Homes**

11 Spartan Homes argues that Far West has a long record as a poorly managed company that has
12 repeatedly disregarded the rules, regulations, and orders of the Commission and ADEQ. Spartan
13 Homes contends that Far West has: historically provided a poor level of customer service;
14 consistently placed the financial interests of its owners and affiliated businesses ahead of its
15 customers by routinely making payments to affiliate customers rather than paying property taxes,
16 AIAC obligations, and other legal obligations; engaged in self-dealing with affiliate H&S
17 Developers; and repeatedly failed to comply with decisions and orders of the Commission and
18 ADEQ. (Spartan Ex. 1, at 3.)

19 Spartan Homes claims that the Company's actions have been devastating financially to
20 Spartan, and forced it to file a formal complaint in 2008 to enforce compliance with the
21 Commission's rules regarding MXAs. Spartan Homes points out that its complaint resulted in the
22 issuance of Decision No. 72594 (September 15, 2011), which ordered Far West to: refund \$154,180
23 to Spartan Homes for failure to follow Commission rules governing MXAs between Far West and
24 Spartan; pay unpaid AIAC refunds under Spartan's sewer MXA; and extend Far West's wastewater
25 CC&N. (*Id.* at 4-5.) Spartan Homes notes that despite the Commission's findings nearly two years
26 ago that Far West violated several Commission rules, as well as the terms of the MXA with Spartan,
27 the Company has still not made the refund ordered by Decision No. 72594; is not current on refunds
28 of advances owed under the sewer collection MXA; and [prior to the close of the hearing in this case]

1 had not filed an application to extend its CC&N as ordered in that Decision. (*Id.*)

2 Based on Far West's lengthy history of non-compliance, Spartan Homes requests that no rate
3 increase be granted until: Far West demonstrates compliance with all rules, regulations and orders of
4 the Commission and ADEQ, and that Far West be required demonstrate that it is current on all AIAC
5 refunds, for both water and wastewater. Spartan Homes claims that because prior Commission orders
6 have not resulted in compliance by Far West, if the Company is permitted to make past due refund
7 payments over time, it should be required to make up all refunds due to Spartan prior to
8 implementing any rate increase, with interest from the date the refunds were due, given Spartan's
9 incurrence of significant expenses in prosecuting its complaint case and intervening in this rate case
10 to enforce compliance. (Spartan Homes' Initial Brief, at 2-3.)

11 Far West contends that Spartan Homes' request that the Company demonstrate compliance
12 with all Commission rules and orders would be impossible because it would essentially require Far
13 West to prove that it is not violating any rules and decisions before it can receive rate relief, and
14 would violate the Company's right to earn a return on the fair value of its property. With respect to
15 the request that the Company be required to be current with all AIAC refund obligations prior to rate
16 implementation, Far West claims that Spartan Homes "is asking Far West to create money out of thin
17 air," because the record in this case shows that the Company does not have enough money to pay
18 salaries, purchased water, purchased power, existing loans, and other expenses until rate relief is
19 granted. Far West argues that such a condition would "set up Far West for certain failure." (Far West
20 Reply Brief at 9-10.)

21 In Decision No. 72594, we required Far West to, among other things: provide sewer service to
22 the remaining 51 lots in Sierra Ridge Unit 1 (Spartan Homes' development); file, within 90 days of
23 the Decision, at the expense of Far West's shareholders, a sewer CC&N extension application
24 encompassing the entire Spartan Property; refund \$154,180 to Spartan Homes within 90 days and file
25 proof of payment, unless an agreement is reached for a later payment date; file, within 90 days, an
26 application for approval of a sewer main extension tariff; prepare a sewer main extension agreement
27 for Sierra Ridge Unit 1 in the same form and content as those it executed with other developers in
28 January 2005, reflecting \$119,092 as the amount upon which refunds will be calculated; and prepare,

1 within 60 days, an accounting demonstrating year-by-year the refunds that should have been made to
2 Spartan Homes from August 31, 2005 to August 31, 2011, and pay within 30 days of such accounting
3 pay the amount due for past refunds. (Decision No. 72594, at 79-81.)

4 That Decision also directed Staff to: as part of Far West's next rate case, investigate and
5 formulate a recommendation about whether Far West has violated A.R.S. § 40-361(B) and any other
6 applicable statute or Commission rule; investigate in the Company's next rate case, the transactions
7 between it and its affiliates, including H&S, and formulate a recommendation about whether the
8 transactions were arm's-length, whether there were written agreements supporting those transactions,
9 and whether any advances have been treated appropriately for rate-making purposes; investigate and
10 formulate a recommendation about Far West's affiliate transactions, including whether there were
11 payments of fees by developers to H&S associated with obtaining utility service; investigate in the
12 Company's next rate case, and formulate a recommendation, about whether the failure of Far West to
13 pay refunds to developers as required by the main extension agreements is a violation of statutes or
14 Commission rules; investigate in the Company's next rate case, and formulate a recommendation,
15 about whether Far West is providing water and/or sewer service to other subdivisions outside of its
16 certificated areas; and initiate an Order to Show Cause proceeding if Staff determined that Far West
17 had violated statutes or Commission rules. (*Id.* at 82-83.)

18 In its testimony, Staff recommended conditioning approval of any rate increase on Far West's
19 paying all of its property tax obligations; becoming current on all amounts due under various MXA's
20 (approximately \$190,000); paying all amounts due to Spartan Homes; becoming compliant fully with
21 ADEQ Consent Orders; and collecting all amounts due the Company from related parties. (Ex. S-5, at
22 26-28.)

23 In its responsive testimony, Far West acknowledged that the items listed by Staff needed to be
24 resolved; however, Mr. Jones indicated that the Company did not have the resources to meet those
25 obligations prior to receiving rate relief, and suggested that imposition of such conditions would
26 exacerbate Far West's tenuous financial condition. (Ex. A-2, at 25-26.) Staff and the Company
27 resolved this dispute by agreeing to the nine conditions discussed above.

28 Although we recognize that the Company, by its own admission, has failed to comply with the

1 directives contained in Decision No. 72594 in any substantial manner, and we appreciate the
2 frustration expressed by Spartan Homes in this proceeding, we believe the conditions set forth in
3 Exhibits A-8 and S-10, as modified and clarified in the discussion above, will provide proper
4 incentive for Far West to become compliant with Commission rules, regulations and orders, including
5 the payment the Company was ordered to make to Spartan Homes in Decision No. 72594. The
6 adoption of the tenth condition, that Staff shall be authorized to appoint an interim manager in the
7 event Far West fails to comply with those conditions, should provide additional incentive to the
8 Company to comply with Commission rules and Orders. With imposition of the described conditions
9 and requirements, we have taken into account the needs of the Company and its customers, and
10 balanced their respective interests, to ensure that Far West remains a viable company that is able to
11 provide ongoing reliable service.

12 **Service Lateral Discrepancy**

13 In his pre-filed testimony, Staff witness Liu indicated that Far West had 10,355 wastewater
14 service laterals during the test year, although it reported having only 7,824 wastewater customers
15 during the same period. (Ex. S-1, at 4; Ex. S-2, at 2.) During the hearing, he acknowledged that the
16 number of service laterals and customers is typically the same, because it reflects the number of
17 customers connected to the system. (Tr. 721-722.)

18 Mr. Jones testified that the discrepancy appeared to be, in part, due to the inclusion by an
19 office employee of 980 RV lots and an extra 106 lots in the Rancho Del Oro subdivision in the
20 number of reported service laterals. (Tr. 953-956.) He testified that he believes there were a number
21 of service laterals included in the Company's 2011 Annual Report that exist, but that are not actually
22 connected to customers. (*Id.* at 956.) Mr. Jones indicated that the Company was going to investigate
23 the discrepancy. (*Id.*)

24 In its brief, RUCO suggested that because the Company did not offer a clear explanation for
25 the discrepancy, no new rates should be approved until an adequate explanation is given. (RUCO
26 Initial Brief, at 18.)

27 Far West argues that no party identified any customers that were taking service during the test
28 year that were not included in the Company's bill counts. The Company claims that the number of

1 laterals on a system is immaterial to ratemaking since only the actual number of customers is relevant
2 to setting rates. Therefore, according to Far West, the claimed discrepancy should not be used as a
3 reason to deny needed rate relief, as suggested by RUCO. (Far West Reply Brief, at 1.)

4 Although we will not condition the effective date of the rates established in this Decision on
5 resolving the difference in reported bill counts and service laterals, we do believe the Company
6 should research the issue and file an explanation for the discrepancy between the two numbers. This
7 explanation or report should be filed within 90 days of the effective date of the Decision. Far West
8 should also ensure that future Annual Reports accurately reflect the number of service laterals, and
9 whether that number also reflects actual customers on the system, in order to avoid confusion in
10 future rate cases.

11 * * * * *

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

14 **FINDINGS OF FACT**

15 1. On July 6, 2012, Far West filed an application for an increase in rates for its
16 wastewater system.

17 2. On August 2, 2012, Staff filed a Letter of Sufficiency indicating that Far West's
18 application met the sufficiency requirements of A.A.C. R14-2-103, and classifying Far West as a
19 Class A Utility.

20 3. Intervention was granted to Spartan Homes, RUCO, Robert and Barbara Gilkey,
21 Robert Rist, Rodney and Kim Taylor, Jerry Durden and Seth and Barbara Davis.

22 4. On August 30, 2012, a Rate Case Procedural Order was issued setting a hearing on the
23 application to commence on April 22, 2013, and establishing associated procedural deadlines.

24 5. On November 8, 2012, Far West filed affidavits of mailing and publication of the
25 required public notice.

26 6. On January 16, 2013, a Procedural Order Modifying Filing Deadlines was issued.

27 ...

28 ...

1 7. On January 25, 2013, a Procedural Order was issued scheduling a public comment
2 meeting in Yuma for February 20, 2013, and directing Far West to mail notice of the public comment
3 meeting to its customers.

4 8. On February 6, 2013, Mr. Rist filed his direct testimony.

5 9. On February 8, 2013, RUCO filed the direct testimony of William Rigsby, Timothy
6 Coley, Royce Duffett, and Thomas Fish.

7 10. On February 11, 2013, the Gilkeys filed their direct testimony.

8 11. On February 13, 2013, Staff filed the direct testimony of Gerald Becker, Jian Liu, and
9 John Cassidy; and Spartan Homes filed the direct testimony of Brian Householder.

10 12. On February 15, 2013, Far West filed an affidavit certifying that mailing of notice of
11 the public comment meeting was completed in accordance with the January 25, 2013, Procedural
12 Order.

13 13. On February 19, 2013, the Gilkeys and Mr. Rist jointly filed their direct rate design
14 testimony.

15 14. On February 20, 2013, a Procedural Order was issued granting Staff's request to
16 modify the rate design testimony filing deadline.

17 15. On February 20, 2013, the Commission conducted a public comment meeting in
18 Yuma, and received comments from numerous customers of Far West.

19 16. On February 21, 2013, RUCO filed the direct rate design testimony of Mr. Coley; and
20 Staff filed the direct rate design testimony of Mr. Becker.

21 17. On February 26, 2013, RUCO filed Notice of Filing Revised Schedules for Mr.
22 Coley's rate design testimony.

23 18. On March 11, 2013, Far West filed the rebuttal testimony of Ray Jones.

24 19. On March 12, 2013, a Procedural Order was issued granting Far West's request for an
25 extension of time to file its rebuttal rate design testimony.

26 20. On March 13, 2013, Far West filed the rebuttal rate design testimony of Mr. Jones.

27 21. On March 22, 2013, the Gilkeys and Mr. Rist filed a Motion to Appoint Interim
28 Manager and Order Forensic and Operational Audits.

1 22. On March 26, 2013, a Procedural Order Modifying Filing Deadline was issued
2 granting RUCO's request for an extension of time to file surrebuttal rate design testimony.

3 23. On March 28, 2013, Commissioner Bitter Smith filed a letter in the docket asking
4 Staff and other parties to provide additional information regarding the need for an interim manager.

5 24. On March 29, 2013, Staff filed the surrebuttal testimony of Mr. Becker, Mr. Liu, and
6 Mr. Cassidy; RUCO filed the surrebuttal testimony of Mr. Rigsby, Mr. Coley, Mr. Duffett, and Dr.
7 Fish; and Spartan Homes filed the surrebuttal testimony of Mr. Householder.

8 25. On April 1, 2013, the Gilkeys and Mr. Rist filed their joint surrebuttal testimony.

9 26. On April 3, 2013, Staff filed the surrebuttal rate design testimony of Mr. Becker;
10 RUCO filed the surrebuttal rate design testimony of Mr. Coley; and the Gilkeys and Mr. Rist filed
11 their joint surrebuttal rate design testimony.

12 27. On April 9, 2013, the Gilkeys and Mr. Rist filed a Joint Response to Commissioner
13 Bitter Smith's letter.

14 28. On April 15, 2013, Staff filed a Memorandum in response to Commissioner Bitter
15 Smith's letter regarding appointment of an interim manager.

16 29. On April 17, 2013, Far West filed the rejoinder testimony of Mr. Jones and a summary
17 of his pre-filed testimony.

18 30. On April 17, 2013, a pre-hearing conference was conducted to discuss scheduling of
19 witnesses and other procedural matters.

20 31. On April 19, 2013, Far West filed a Response to Intervenors' Motion regarding the
21 request for an interim manager and forensic and operational audits.

22 32. On April 22, 2013, the evidentiary hearing commenced beginning with public
23 comment and opening statements. The hearing continued on April 23, 24, 25, and 26, 2013. Far
24 West, RUCO, Spartan Homes, and Staff appeared through counsel, and the Gilkeys and Mr. Rist
25 appeared in propria persona.

26 33. On April 23, 2013, Far West filed a letter in response to customer complaints made to
27 ADEQ regarding the Company's operations.

28 34. On May 3, 2013, Final Schedules were filed by Far West, Staff, and RUCO.

- 1 35. On June 10, 2013, the Gilkeys and Mr. Rist filed their joint initial brief.
- 2 36. On June 11, 2013, Far West, RUCO, Spartan Homes, and Staff filed their initial briefs.
- 3 37. On June 28, 2013, Far West filed an Informational Filing Concerning Improper Debt
4 Collection Practices.
- 5 38. On June 28, 2013, the Gilkeys and Mr. Rist filed their joint reply brief.
- 6 39. On July 2, 2013, Far West and RUCO filed their reply briefs.
- 7 40. On July 2, 2013, Staff filed a notice that it would not be filing a reply brief.
- 8 41. Based on the discussion herein, Far West's wastewater division has an OCRB and
9 FVRB of \$19,983,089.
- 10 42. Far West's test year revenues for its wastewater division were \$2,231,115.
- 11 43. Far West's test year operating expenses for its wastewater division were \$2,830,455.
- 12 44. Far West's test year adjusted operating income for its wastewater division was
13 (\$599,341).
- 14 45. Far West's cost of common equity is determined to be 9.50 percent; its short-term cost
15 of debt is 7.51 percent; and its long-term cost of debt is 6.66 percent.
- 16 46. Far West's capital structure is determined to consist of 20.82 percent equity, 4.95
17 percent short-term debt, and 74.23 percent long-term debt, and its weighted average cost of capital is
18 determined to be 7.29 percent.
- 19 47. Applying the Company's 7.29 percent WACC to its FVRB of \$19,983,089 results in
20 required operating income of \$1,456,767, which combined with adjusted test year income of
21 (\$599,341), produces an operating income deficiency of \$2,056,108. Applying a gross revenue
22 conversion factor of 1.6612 results in a determination that Far West's wastewater division is entitled
23 to a gross revenue increase of \$3,415,622. However, for the reasons discussed herein, Far West must
24 implement the authorized increase in accordance with the conditions discussed above.
- 25 48. The rates established in this proceeding will not become effective until Far West has
26 filed written documentation from ADEQ showing that the Company has satisfied fully the terms of
27 all current Consent Orders with ADEQ, and any other remaining ADEQ compliance issues. The
28

1 Company may put the authorized rates into effect on the first day of the month following the filing of
2 such documentation in a form that is acceptable to Staff.

3 49. Far West is required to satisfy fully all outstanding payments due to Spartan Homes as
4 ordered in Decision No. 72594. The Company may put the authorized rates into effect on the first
5 day of the month following the filing of such documentation of payment in a form that is acceptable
6 to Staff.

7 50. Far West will be required to implement 50 percent of the established rates upon
8 satisfaction of the conditions as discussed herein, with the full rates becoming effective six months
9 thereafter. Notice of both phases of rates must be given to customers prior to the effectiveness in a
10 form acceptable to Staff. Notice of the second rate phase increase shall be given within 30 days prior
11 to those rates being implemented. Far West will not be entitled to recover any lost revenue or interest
12 associated with the rate phase-in, in accordance with the agreement in Exhibit A-8.

13 51. Far West will be required to submit documentation of a payment plan with Yuma
14 County for payment of all delinquent property taxes and penalties. Documentation must be filed
15 showing written agreement by the County to the payment plan, and the agreement with the County
16 must be filed prior to the rates in this case becoming effective. The Company may put the authorized
17 rates into effect on the first day of the month following the filing of such documentation in a form
18 that is acceptable to Staff.

19 52. Far West will be required to make arrangements to make monthly payments to
20 developers under MXAs and all amounts due should be paid fully by no later than June 30, 2015, and
21 prior to the rates in this case becoming effective Far West must file documentation showing a full
22 accounting of all developers owed money under MXAs, the amounts owed to each entity, and a
23 detailed plan of the monthly amounts to be paid to each developer that will enable all MXA amounts
24 to become current by no later than June 30, 2015. The Company may put the authorized rates into
25 effect on the first day of the month following the filing of such documentation in a form that is
26 acceptable to Staff. In addition, Far West must file every 180 days following the effective date of the
27 rates in this case, a ledger or other documentation showing all amounts paid to developers in
28 compliance with its MXA payment plan.

1 53. Far West will be required to collect all amounts owed by related or affiliated entities to
2 the Company (*i.e.*, any companies or entities with common ownership or control) by the earlier of 12
3 months from the effective date of the Phase 1 rates or December 31, 2014, and prior to the rates in
4 this case becoming effective, Far West must file documentation showing a full accounting of the
5 related/affiliated entities that owe Far West money, the amounts owed by each entity, and a detailed
6 plan of the monthly amounts to be paid by each entity that will enable all amounts due to become
7 current by the earlier of 12 months from the effective date of Phase 1 rates or December 31, 2014.
8 The Company may put the authorized rates into effect on the first day of the month following the
9 filing of such documentation in a form that is acceptable to Staff. In addition, Far West must file
10 every 180 days following the effective date of the rates in this case, until paid in full, a ledger or other
11 documentation showing all amounts paid by related/affiliated entities in compliance with the
12 proposed payment plan.

13 54. Effluent rates will be charged by Far West at the greater of \$0.25 per thousand gallons
14 or local market rates.

15 55. The RV tariff language agreed to by the parties shall be incorporated into Far West's
16 tariffs in compliance with this Decision, prior to the rates becoming effective.

17 56. Far West will be required to develop and adopt a formal written affiliate transaction
18 policy consistent with Condition No. 9 in Exhibit A-8. The Company must file the affiliate
19 transaction policy within 30 days of the effective date of Phase 1 rates, and the policy will be subject
20 to Staff's review and may be modified as may be deemed necessary by Staff.

21 57. Given Far West's history of non-compliance with Commission Orders, it is
22 appropriate in this case to grant Staff the authority, without further action of the Commission, to
23 appoint an interim manager if the Company fails to comply with the modified conditions discussed
24 herein. In the event that Staff appoints an interim manager, Staff shall make a filing in this docket,
25 within 30 days of such appointment, informing the Commission and other parties to this case.

26 58. Subject to compliance with the ten rate increase conditions discussed herein, Far West
27 is authorized to file tariffs that provide for a two-phase rate increase with a residential Phase 1
28 increase of \$17.55 per month, from the current \$21.75 to \$39.30, or 80.69 percent. Six months

1 following the effective date of the Phase 1 rates, the full rate increase will take effect, and the
2 residential wastewater rate will increase to \$57.41 per month, a total dollar increase from current
3 rates of \$35.66, or 163.95 percent over current rates. (See Attachments 1 and 2.)

4 59. Far West must research the service lateral discrepancy issue and file an explanation for
5 the discrepancy between reported service laterals and bill counts, to be filed within 90 days of the
6 effective date of the Decision. Far West must also ensure that future Annual Reports accurately
7 reflect the number of service laterals, and whether that number also reflects actual customers on the
8 system, in order to avoid confusion in future rate cases.

9 **CONCLUSIONS OF LAW**

10 1. Far West is a public service corporation within the meaning of Article XV of the
11 Arizona Constitution and A.R.S. §§ 40-250, 40-251, and 40-367.

12 2. The Commission has jurisdiction over Far West and the subject matter of the above-
13 captioned case.

14 3. The fair value of Far West's rate base is \$19,983,089, and applying a 7.29 percent rate
15 of return on this fair value rate base produces rates and charges that are just and reasonable, subject to
16 the rate phase-in agreed to by the Company during the hearing in this matter, as well as compliance
17 with the conditions discussed herein.

18 4. The rates, charges, approvals, and conditions established herein are just and
19 reasonable and in the public interest.

20 **ORDER**

21 IT IS THEREFORE ORDERED that Far West Water & Sewer, Inc., is hereby authorized and
22 directed to file with the Commission, on or before September 30, 2013, revised schedules of rates and
23 charges consistent with the discussion herein, including a two-step phase-in, and a proof of revenues
24 showing that the revised rates will produce no more than the authorized increase in gross revenues.

25 IT IS FURTHER ORDERED that the revised schedule of rates and charges for Phase 1 shall
26 be effective for all service rendered after the date has complied with all conditions discussed herein
27 that require compliance filings prior to the implementation of the authorized rates.
28

1 IT IS FURTHER ORDERED that the rates established in this proceeding will not become
2 effective until Far West has filed written documentation from ADEQ showing that the Company has
3 satisfied fully the terms of all current Consent Orders with ADEQ, and any other remaining ADEQ
4 compliance issues. The Company may put the authorized rates into effect on the first day of the
5 month following the filing of such documentation in a form that is acceptable to Staff.

6 IT IS FURTHER ORDERED that Far West Water & Sewer, Inc., shall satisfy fully all
7 outstanding payments due to Spartan Homes as ordered in Decision No. 72594. The Company may
8 put the authorized rates into effect on the first day of the month following the filing of such
9 documentation in a form that is acceptable to Staff.
10

11 IT IS FURTHER ORDERED that Far West Water & Sewer, Inc., is authorized to implement
12 50 percent of the established rates upon satisfaction of the conditions as discussed herein, with the
13 full rates becoming effective six months thereafter. Notice of both phases of rates shall be given to
14 customers prior to the effectiveness of the rates in a form acceptable to Staff. Notice of the second
15 rate phase increase shall be given within 30 days prior to those rates being implemented. Far West
16 shall not be entitled to recover any lost revenue or interest associated with the rate phase-in, in
17 accordance with the agreement in Exhibit A-8.
18

19 IT IS FURTHER ORDERED that Far West Water & Sewer, Inc., shall be required to submit
20 documentation of a payment plan with Yuma County for payment of all delinquent property taxes
21 and penalties. Documentation shall be filed showing written agreement by the County to the
22 payment plan, and Far West shall file this agreement prior to the rates in this case becoming effective.
23 The Company may put the authorized rates into effect on the first day of the month following the
24 filing of such documentation in a form that is acceptable to Staff.
25

26 IT IS FURTHER ORDERED that Far West Water & Sewer, Inc., shall make arrangements to
27 make monthly payments to developers under MXAs and all amounts due shall be paid fully by no
28

1 later than June 30, 2015, and, prior to the rates in this case becoming effective, Far West must file
2 documentation showing a full accounting of all developers owed money under MXAs, the amounts
3 owed to each entity, and a detailed plan of the monthly amounts to be paid to each developer that will
4 enable all MXA amounts to become current by no later than June 30, 2015. The Company may put
5 the authorized rates into effect on the first day of the month following the filing of such
6 documentation in a form that is acceptable to Staff. In addition, Far West shall file every 180 days
7 following the effective date of the rates in this case, until paid in full, a ledger or other documentation
8 showing all amounts paid to developers in compliance with its MXA payment plan.
9

10 IT IS FURTHER ORDERED that Far West Water & Sewer, Inc., shall collect all amounts
11 owed by related or affiliated entities to the Company (*i.e.*, any companies or entities with common
12 ownership or control) by the earlier of 12 months from the effective date of the Phase 1 rates or
13 December 31, 2014, and prior to the rates in this case becoming effective, Far West shall file
14 documentation showing a full accounting of the related/affiliated entities that owe Far West money,
15 the amounts owed by each entity, and a detailed plan of the monthly amounts to be paid by each
16 entity that will enable all amounts due to become current by the earlier of 12 months from the
17 effective date of Phase 1 rates or December 31, 2014. The Company may put the authorized rates
18 into effect on the first day of the month following the filing of such documentation in a form that is
19 acceptable to Staff. In addition, Far West shall file every 180 days following the effective date of the
20 rates in this case, until paid in full, a ledger or other documentation showing all amounts paid by
21 related/affiliated entities in compliance with the proposed payment plan.
22
23

24 IT IS FURTHER ORDERED that Far West Water & Sewer, Inc., shall file tariffs with an
25 effluent rate of \$0.25 per thousand gallons or local market rates.

26 IT IS FURTHER ORDERED that Far West Water & Sewer, Inc., shall file tariffs with RV
27 Park tariff language agreed to by the parties, which tariff shall be incorporated into Far West's rates
28

1 in compliance with this Decision, prior to the rates becoming effective.

2 IT IS FURTHER ORDERED that Far West Water & Sewer, Inc., shall develop and adopt a
3 formal written affiliate transaction policy consistent with Condition No. 9 in Exhibit A-8. The
4 Company shall file the affiliate transaction policy within 30 days of the effective date of Phase 1
5 rates, and the policy will be subject to Staff's review and may be modified as may be deemed
6 necessary by Staff.

7 IT IS FURTHER ORDERED that Staff shall be authorized, without further action of the
8 Commission, to appoint an interim manager if the Company fails to comply with the modified
9 conditions discussed herein.
10

11 IT IS FURTHER ORDERED that in the event that Staff appoints an interim manager, Staff
12 shall make a filing in this docket, within 30 days of such appointment, informing the Commission
13 and other parties to this case.

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1 IT IS FURTHER ORDERED that Far West Water & Sewer, Inc., shall research the service
2 lateral discrepancy issue discussed herein and file, within 90 days of the effective date of this
3 Decision, an explanation for the discrepancy with the reported bill counts. Far West shall also ensure
4 that future Annual Reports accurately reflect the number of service laterals, and whether that number
5 also reflects actual customers on the system, in order to avoid confusion in future rate cases.

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

7
8 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

9
10 _____
11 CHAIRMAN COMMISSIONER

12
13 _____
14 COMMISSIONER COMMISSIONER COMMISSIONER

15 IN WITNESS WHEREOF, I, JODI JERICH, Executive
16 Director of the Arizona Corporation Commission, have
17 hereunto set my hand and caused the official seal of the
18 Commission to be affixed at the Capitol, in the City of Phoenix,
19 this _____ day of _____ 2013.

20 _____
21 JODI JERICH
22 EXECUTIVE DIRECTOR

23 DISSENT _____

24 DISSENT _____
25 DN:dap

1 SERVICE LIST FOR: FAR WEST AND SEWER, INC.

2 DOCKET NO.: WS-03478A-12-0307

3

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28 1200 West Washington Street
Phoenix, AZ 85007

26

27

28 Steven M. Olea, Director
Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, AZ 85007

28

	Authorized Rates Phase 1	Authorized Rates Phase 2
Monthly Usage Charge-		
Residential - All except RV	\$ 39.30	\$ 57.41
RV Spaces	\$ 13.10	\$ 19.14
Commercial - ALL	N/A	N/A
Commercial - 5/8"	\$ 58.95	\$ 86.12
Commercial - 3/4"	\$ 58.95	\$ 86.12
Commercial - 1"	\$ 102.18	\$ 149.27
Commercial - 1 1/2"	\$ 204.36	\$ 298.53
Commercial - 2"	\$ 322.26	\$ 470.76
Commercial - 3"	\$ 628.80	\$ 918.56
Commercial - 4"	\$ 982.50	\$ 1,435.25
Commercial - 6", except Rancho Rialto	\$ 1,965.00	\$ 2,870.50
RV Parks-Common Areas only	\$ 58.95	\$ 86.12
Commodity Charges		
Sale of Effluent, per thousand gallons	"Market" rate, minimum \$0.25 and no maximum	"Market" rate, minimum \$0.25 and no maximum
Service Charges		
Establishment	40.00	40.00
Reconnection (Delinquent)	30.00	30.00
Deposit (Residential)	Per Rule*	Per Rule*
Deposit (Non-Residential)	Per Rule**	Per Rule**
Deposit Interest	Per Rule***	Per Rule***
Re-Establishment (Within 12 Months)	Per Rule****	Per Rule****
NSF Check	30.00	30.00
Deferred Payment, Per Month	1.5%	1.5%
Late Payment, Per Month	1.5%	1.5%
Disconnect and Reconnect (Delinquent)	Cost*****	Cost*****
After Hours Service Charge	35.00	35.00

- * Per Commission Rules (R14-2-603.B.7.a.)
- ** Per Commission Rules (R14-2-603.B.7.b.)
- *** Per Commission Rules (R14-2-603.B.3)
- **** Months off system times the minimum (R14-2-603.D.1)
- ***** For Non-Far West water customers only

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 Rule 14-2-608(D)(5).

TYPICAL BILL ANALYSIS
RESIDENTIAL

	Present Rates	Authorized Rates	Dollar Increase	Percent Increase
Phased 1 - 50 Percent				
All Residential	\$ 21.75	\$ 39.30	\$ 17.55	80.69%
Phased 2 - 100 Percent				
All Residential	\$ 21.75	\$ 57.41	\$ 35.66	163.95%

DECISION NO. _____