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**BEFORE THE ARIZONA CORPORATION COMMISSION**

COMMISSIONERS

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

Arizona Corporation Commission
DOCKETED
SEP 23 2013
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IN THE MATTER OF THE APPLICATION OF FAR WEST WATER AND SEWER, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS WASTEWATER RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE.

DOCKET NO. WS-03478A-12-0307

DECISION NO. 74097

**OPINION AND ORDER**

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

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Dwight D. Nodes

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

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

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

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

Mr. Robert Rist, in propria persona; and

Mr. Wesley Van Cleve and Ms. Robin Mitchell, Staff Attorneys, Legal Division, on behalf of the Utilities 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-

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Kim Taylor.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

comments.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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[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.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## II. APPLICATION

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

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

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

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

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

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

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

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

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

[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.

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

## III. RATE BASE ISSUES

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

### Zenon Treatment Equipment at Seasons WWTP

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

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

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

[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.

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

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

**AFUDC**

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

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

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

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

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

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

**Management Fees**

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

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

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

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

**Excess Capacity**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Working Capital**

During the course of the proceeding, Far West, Staff, and RUCO came to agreement regarding the methodology for calculating working capital, and their differing recommendations for a working capital allowance are based only on their respective positions regarding the disputed rate base issues. Given the findings described above, we find that Far West is entitled to working capital in the amount of $1,446,844.

**Summary of Rate Base Adjustments**

Based on the foregoing discussion, we adopt and adjusted OCRB and FVRB of $19,989,045 for Far West in this proceeding.

| | Commission Approved |
|---|---|
| OCRB | |
| Gross Plant in Service | $34,389,224 |
| Less: Accumulated Depreciation | 4,810,783 |
| Net Plant in Service | $29,578,441 |

| | |
|---|---|
| Deductions: | |
| AIAC | $10,192,451 |
| CIAC | 1,726,854 |
| Accum. Amort. of CIAC | (909,423) |
| Net CIAC | $817,431 |
| Customer Security Deposits | $26,359 |
| Additions: | |
| Allowance for Working Capital | $1,446,844 |
| Total OCRB | $19,989,045 |

## IV. INCOME STATEMENT

Over the course of the proceeding, the parties presenting revenue requirement proposals (*i.e.*, Far West, Staff, and RUCO) came to agreement on all income statement issues. Therefore, the only remaining income statement issues relate to interest, depreciation, property tax, and income tax expenses – all of which flow from the parties' respective positions regarding rate base and cost of capital positions. However, the parties do not disagree on the methodology that should be used to calculate these expense adjustments. Based on our findings herein, we find Far West's adjusted test year operating expenses to be $2,801,659, which based on adjusted test year revenues of $2,231,115, results in test year adjusted operating income of ($570,545).

## V. COST OF CAPITAL

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

### Capital Structure

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

1.)

**Cost of Debt**

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

**Cost of Equity**

Far West

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

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

RUCO

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

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[7] In its initial brief, Far West included tables purporting to represent recent returns on equity, costs of debt, and WACCs granted by the Commission to various companies, as well as arguments based on that information. (Co. Initial Brief at 13-16.) RUCO argued in its reply brief that the Commission should strike that portion of the Company's brief because it presented new evidence not introduced at the hearing and would therefore constitute a denial of due process if relied upon by the Commission in rendering a decision. (RUCO Reply Brief at 10-11.) Although we do not agree with RUCO that 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.)

(*Id.*)

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

Staff

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

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

Conclusion

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

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

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

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

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[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).

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

**Cost of Capital Summary**

| | Weight | Cost | Weighted Avg. Cost |
|---|---|---|---|
| Common Equity | 20.82% | 9.50% | 1.98% |
| Short-Term Debt | 4.95% | 7.51% | 0.37% |
| Long-Term Debt | 74.23% | 6.66% | 4.94% |
| Weighted Avg. Cost of Capital | | | 7.29% |

## VI. AUTHORIZED REVENUE INCREASE

Based on the discussion herein, the authorized total revenue increase is $3,368,507.

| | |
|---|---|
| Fair Value Rate Base | $19,989,045 |
| Required Fair Value Rate of Return | 7.29% |
| Required Operating Income | $1,457,201 |
| Adjusted Operating Income (Loss) | (570,545) |
| Operating Income Deficiency | 2,027,746 |
| Gross Revenue Conversion Factor | 1.661208 |
| Gross Revenue Increase | $3,368,507 |

## VII. RATE DESIGN

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

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

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

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

**Rate Increase Conditions**

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

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.

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.

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.

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

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

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

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

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

ADEQ Compliance

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

Spartan Homes

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

[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.

Rate Phase-In

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

Property Taxes

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

MXAs

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

Collections from Related Parties

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

Effluent Rates

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

RV Tariff Language

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

Affiliate Transaction Policy

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

Interim Manager

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

conditions discussed above.

**Approved Rates and Charges**

Based on the foregoing discussion, and subject to Far West's compliance with the requirements set forth above, the rates and charges for residential and commercial wastewater service shown in Attachment 1 are approved. As shown in Attachment 2, residential customers will experience a Phase 1 increase of $17.30 per month, from the current $21.75 to $39.05, or 79.55 percent. Six months following the effective date of the Phase 1 rates, the full rate increase will take effect, and the residential wastewater rate will increase to $56.92 per month, a total dollar increase over current rates of $35.17, or 161.69 percent. (*See* Attachment 2.)

## VIII. INTERVENOR ISSUES

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

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

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

. . .

[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.

**Company Background and Regulatory History**

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

**Decision No. 71447**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Interim Manager**

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

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

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

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

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

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

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

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

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

[12] In its Reply Brief, Far West also stated that the Capestros were not available at the hearing because Mrs. Capestro 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.)

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

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

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

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

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

**Forensic Audit**

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

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

[13] During the hearing, Staff witness Becker defined a "forensic audit" as "probably the most thorough examination of an organization or individual's affairs…[and] would include things like mapping out cash flow transactions, the cash receipts 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.)

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

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

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

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

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

**Spartan Homes**

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

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

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

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

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

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

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

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

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

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

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

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

**Service Lateral Discrepancy**

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

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

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

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

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

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

* * * * * * * * * *

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

## FINDINGS OF FACT

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

41. Based on the discussion herein, Far West's wastewater division has an OCRB and FVRB of $19,989,045.

42. Far West's test year revenues for its wastewater division were $2,231,115.

43. Far West's test year operating expenses for its wastewater division were $2,801,659.

44. Far West's test year adjusted operating income for its wastewater division was ($570,545).

45. Far West's cost of common equity is determined to be 9.50 percent; its short-term cost of debt is 7.51 percent; and its long-term cost of debt is 6.66 percent.

46. Far West's capital structure is determined to consist of 20.82 percent equity, 4.95 percent short-term debt, and 74.23 percent long-term debt, and its weighted average cost of capital is determined to be 7.29 percent.

47. Applying the Company's 7.29 percent WACC to its FVRB of $19,989,045 results in required operating income of $1,457,201, which combined with adjusted test year income of ($570,545), produces an operating income deficiency of $2,027,746. Applying a gross revenue conversion factor of 1.6612 results in a determination that Far West's wastewater division is entitled to a gross revenue increase of $3,368,507. However, for the reasons discussed herein, Far West must implement the authorized increase in accordance with the conditions discussed above.

48. The rates established in this proceeding will not become effective until Far West has filed written documentation from ADEQ showing that the Company has satisfied fully the terms of all current Consent Orders with ADEQ, and any other remaining ADEQ compliance issues. The

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

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

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

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

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

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

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

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

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

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

58. Subject to compliance with the ten rate increase conditions discussed herein, Far West is authorized to file tariffs that provide for a two-phase rate increase with a residential Phase 1 increase of $17.30 per month, from the current $21.75 to $39.05, or 79.55 percent. Six months

following the effective date of the Phase 1 rates, the full rate increase will take effect, and the residential wastewater rate will increase to $56.92 per month, a total dollar increase from current rates of $35.17, or 161.69 percent over current rates. (See Attachments 1 and 2.)

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

## CONCLUSIONS OF LAW

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

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

3. The fair value of Far West's rate base is $19,989,045, and applying a 7.29 percent rate of return on this fair value rate base produces rates and charges that are just and reasonable, subject to the rate phase-in agreed to by the Company during the hearing in this matter, as well as compliance with the conditions discussed herein.

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

## ORDER

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER

COMMISSIONER COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, JODI JERICH, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 23rd day of September 2013.

JODI JERICH
EXECUTIVE DIRECTOR

DISSENT Brenda Burns

DISSENT
DN:dap

SERVICE LIST FOR: FAR WEST AND SEWER, INC.

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

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Far West Water Sewer., Inc., Sewer Division
Docket No. WS-03478A-12-0307
*Test Year Ended December 31, 2011*

**RATE DESIGN**

**ATTACHMENT 1**

| | Authorized Rates Phase 1 | Authorized Rates Phase 2 |
|---|---|---|
| Monthly Usage Charge- | | |
| Residential - All except RV | $ 39.05 | $ 56.92 |
| RV Spaces | $ 13.02 | $ 18.97 |
| Commercial - ALL | N/A | N/A |
| Commercial - 5/8" | $ 58.58 | $ 85.38 |
| Commercial - 3/4" | $ 58.58 | $ 85.38 |
| Commercial - 1" | $ 101.54 | $ 147.98 |
| Commercial - 1 1/2" | $ 203.07 | $ 295.97 |
| Commercial - 2" | $ 320.23 | $ 466.72 |
| Commercial - 3" | $ 624.84 | $ 910.67 |
| Commercial - 4" | $ 976.31 | $ 1,422.92 |
| Commercial - 6", except Rancho Rialto | $ 1,952.62 | $ 2,845.85 |
| RV Parks-Common Areas only | $ 58.58 | $ 85.38 |
| 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).

DECISION NO. 74097

Far West Water Sewer, Inc., Sewer Division
Docket No. WS-03478A-12-0307
Test Year Ended December 31, 2011

TYPICAL BILL ANALYSIS
RESIDENTIAL

ATTACHMENT 2

| | Present Rates | Authorized Rates | Dollar Increase | Percent Increase |
|---|---|---|---|---|
| | | **Phased 1 - 50 Percent** | | |
| All Residential | $ 21.75 | $ 39.05 | $ 17.30 | 79.55% |
| | | **Phased 2 - 100 Percent** | | |
| All Residential | $ 21.75 | $ 56.92 | $ 35.17 | 161.69% |

DECISION NO. 74097