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

OPEN MEETING ITEM

0000150619

ARIZONA CORPORATION COMMISSION

RECEIVED

2013 DEC 31 P 1:09

AZ CORP COMMISSION
DOCKET CONTROL

DATE: DECEMBER 31, 2013

DOCKET NO.: W-01737A-12-0478

ORIGINAL

TO ALL PARTIES:

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

NEW RIVER UTILITY COMPANY
(RATES)

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

JANUARY 9, 2014

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

JANUARY 14, 2014 and JANUARY 15, 2014

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

Arizona Corporation Commission
DOCKETED
DEC 31 2013
DOCKETED BY

JODI JERICH
EXECUTIVE DIRECTOR

This document is available in alternative formats by contacting Shaylin Bernal, ADA Coordinator, voice phone number 602-542-3931, E-mail SABernal@azcc.gov.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF NEW RIVER UTILITY COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS WATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO. W-01737A-12-0478 DECISION NO. _____ **OPINION AND ORDER**

DATES OF HEARING:	September 4, 2013 (Pre-hearing conference); September 9, 2013 (public comment); September 12 and 13, 2013.
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Sarah N. Harpring
APPEARANCES:	Mr. Jeffrey W. Crockett, BROWNSTEIN HYATT FARBER SCHRECK, LLP, on behalf of Applicant; and Mr. Brian E. Smith and Mr. Scott M. Hesla, Staff Attorneys, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

This case concerns an application for a permanent rate increase filed by New River Utility Company ("New River"), an Arizona "S" corporation and Class B water utility providing service to approximately 2,900 connections in Peoria, Arizona. New River's application uses a test year ending December 31, 2011 ("TY"). For the TY, New River reported adjusted gross revenues of $1,260,429 and operating income of $116,225. New River is requesting an overall gross revenue increase of $761,820, or 60.44 percent, which New River stated would produce operating income of $586,849 and would represent an 8.72-percent return on an adjusted fair value rate base ("FVRB") of $6,729,925.

DISCUSSION **3**
I. Background **3**
II. Procedural History **5**
III. Application & Summary **8**
IV. Rate Base Issues **10**
A. Inadequately Supported Plant 10
B. Depreciation Methodology 13
C. Depreciation for Inadequately Supported Plant 20
D. Working Capital 20
E. Fair Value Rate Base Summary 21
V. Operating Income **21**
A. Test Year Revenues 21
B. Test Year Operating Expenses 21
1. Salaries and Wages 22
2. Repairs and Maintenance 25
a. Inadequately Supported Credit Card Charges 25
b. Tank Painting 28
3. Rent, Buildings 30
a. Office Building 31
b. 87th Ave. property 32
c. Workshop Facility 34
d. Resolution 36
4. Rent, Vehicles 38
5. Transportation 42
6. Bad Debt 43
7. Depreciation 44
8. Income Tax 45
9. Taxes Other Than Income 45
C. Operating Income Summary 46
VI. Cost of Capital **46**
A. Capital Structure 46
B. Cost of Equity & Fair Value Rate of Return 46
1. New River 46
2. Staff 48
3. Discussion and Resolution 52
C. Cost of Capital Summary 53
VII. Revenue Requirement **53**
VIII. Rate Design **54**
IX. Emergency Purchased Water Surcharge & Tariff **62**
X. Best Management Practices **63**
XI. Inter-Affiliate Transfers of Funds **65**
FINDINGS OF FACT **70**
CONCLUSIONS OF LAW **78**
ORDER **78**

BY THE COMMISSION:

DISCUSSION

I. BACKGROUND

New River is an Arizona "S" corporation and Class B water utility providing service in the City of Peoria, in Maricopa County, pursuant to a Certificate of Convenience and Necessity ("CC&N") granted by the Arizona Corporation Commission ("Commission") in 1961. (Ex. A-1 at 1; Ex. S-1 at 2.) New River's current rates were approved by the Commission in Decision No. 65134 (August 22, 2002),[1] using a test year ending December 31, 2000. (Ex. A-1 at 2.)

In 2000, New River served approximately 1,150 connections. (Jones Dir.[2] at 4.) Since then, New River's service connections have more than doubled. (*Id.* at 4.) New River's service area is approximately 1.75 square miles in size and is now almost built out, with approximately 2,924 connections. (*Id.* at 4, Sched. H-2; Ex. S-6 at ex. MSJ at 1, 4.) Most of New River's customers are residential, with New River serving approximately 2,240 residential 5/8" x 3/4" meters and approximately 546 residential 1" meters during the 2011 TY. (*See* Jones Dir. at 3, Sched. H-2.) New River's 5/8" x 3/4" residential customers have relatively high water consumption, with average monthly water usage of 11,183 gallons and median monthly water usage of 8,762 gallons, something that New River attributes to its relatively low rates and charges. (*See* Jones Dir. at 3, Sched. H-5.)

New River is wholly owned by Robert Fletcher and Karen Fletcher. (Tr. at 60.) Mr. Fletcher serves as New River's President and Chief Executive Officer, and Mrs. Fletcher serves as its Office Manager and Secretary-Treasurer, for which they are paid, respectively, salaries of $150,000 and $60,000. (Ex. A-12.) New River also employs a customer service representative, at a salary of $40,000; a field technician, at a salary of $21,600 plus housing valued at $14,400 for the TY; and an operations assistant, at a rate of $10.00 per hour. (*Id.*) The Fletchers also receive medical expense reimbursement, which amounted to $22,325.80 for the TY. (*Id.*) No timesheets are used to track the hours worked by New River's employees. (*Id.*)

. . .

---

[1] Official notice is taken of Decision No. 65134 (August 22, 2002).

[2] Mr. Jones's direct testimony was included in Exhibit A-1 and is cited herein as "Jones Dir." for brevity's sake.

New River is affiliated with several other entities owned by the Fletchers, including Cody Farms, Inc. ("Cody Farms"); Fletcher Enterprises; Fletcher Farms, Inc.; and Mary R, LLC. (Ex. A-10; Tr. at 62-64.) Of these affiliates, only Cody Farms is currently engaged in active business operations, which include ownership and operation of a cattle ranch in the Clifton/Morenci area, and ownership and management of "remnant" properties and personal property, some of which are rented to New River. (*See* Ex. A-10; Tr. at 63-64.) During the TY, New River paid management fees and rent to Cody Farms. (Ex. A-10.) Cody Farms also has a Main Extension Agreement ("MXA") with New River. (Ex. A-10.) In its application, New River identified $75,000 in management fees for the TY.[3] (Jones Dir. at Sched. C-1.) During the case, New River agreed to have these expenses reclassified, as Cody Farms does not actually provide any management services to New River. (Tr. at 126.)

New River's service area is located in the Phoenix Active Management Area ("AMA"), and New River currently is enrolled in the Arizona Department of Water Resources' ("ADWR's") Modified Non Per Capita Conservation Program as a regulated Tier I municipal provider, with a Public Education Program and one ADWR-approved best management practice ("BMP").[4] (Jones Dir. at 4.) In recent years, New River has added a new well to its system (Well No. 4), installed an arsenic treatment facility at its 87th Avenue Booster Plant, and constructed an interconnection with the City of Peoria (completed post-TY in 2012). (*Id.* at 4-5.) In March 2013, New River had two wells break down, and New River was forced to purchase water from the City of Peoria to meet customer water demands. (Ex. S-1 at 54.) New River purchased just over 3 million gallons of water for a total purchased water cost of $11,292. (*Id.*)

As of Staff's field inspection in March 2013, New River's system consisted of four active wells with a flow capacity of 2,485 gallons per minute, three 1-million gallon storage tanks with a cumulative storage capacity of 3 million gallons, two booster systems, and a distribution system serving approximately 2,925 service connections. (Ex. S-6 at ex. MSJ at 1.) Staff's Engineer

---

[3] For the two years prior to the TY, New River showed $500,000 in annual "management fees," but showed no officer and director salaries, no contract services for accounting and legal services, significantly lower contracting services for other services, significantly lower transportation expenses, and no bad debt expense. (*See* Jones Dir. at Sched. E-2.)

[4] New River's "Meter Repair and/or Replacement Program" BMP was approved by ADWR on June 24, 2010.

determined that New River had completed an interconnection with the City of Peoria in April 2012, consisting of a 6-inch compound meter with backflow prevention assembly. (*Id.*) Staff also found New River's production capacity and storage capacity adequate to serve its present customer base and reasonable growth. (*Id.* at ex. MSJ at 4.)

During the TY, New River had water loss of 8.6 percent, which is within the Commission's standard for water loss not to exceed 10 percent. (*Id.* at ex. MSJ at 5.) According to New River, its water loss was lower in prior years, at 7.6 percent in 2010 and at an average of 7.31 percent for the years 2007 through 2009. (Jones Dir. at 5.)

In February 2013, the Maricopa County Environmental Services Department reported that New River was providing water meeting the water quality standards of Title 40, Part 141 of the Code of Federal Regulations and Arizona Administrative Code ("A.A.C.") Title 18, Chapter 4. (*Id.* at ex. MSJ at 5.) In February 2013, ADWR reported that New River was in compliance with ADWR's requirements governing water providers and/or community water systems. (*Id.* at ex. MSJ at 6.) Staff's Compliance Section also reported, in May 2013, that there were no delinquent compliance items for New River. (*Id.* at ex. MSJ at 5-6.) New River has an approved curtailment tariff and an approved backflow prevention tariff on file with the Commission. (*Id.* at ex. MSJ at 7.)

According to the Commission's Consumer Services Section, the Commission received two customer complaints regarding New River in 2010, four complaints in 2011, no complaints in 2012, and one complaint in 2013, with all of the complaints resolved and closed. (Ex. S-1 at 3.)

II. PROCEDURAL HISTORY

On November 29, 2012, New River filed with the Commission a permanent rate application reporting TY adjusted gross revenues of $1,260,429 and requesting an overall gross revenue increase of $1,087,457, or 86.28 percent, which New River stated would represent an 8.72-percent return on an adjusted FVRB of $7,812,036. (Ex. A-1 at 3-4.) New River stated that it needed a rate increase because its revenues from utility operations were inadequate to allow New River to recover its operating costs and a just and reasonable return on the fair value of its utility plant and property devoted to public service and used to provide utility service to its customers. (*Id.* at 2.) New River's application included the direct testimony of Ray L. Jones, Principal of ARICOR Water Solutions,

LC, a consultant. (Ex. A-1.) New River's application proposed that its FVRB be determined using both its original cost rate base ("OCRB") and its reconstruction cost new rate base ("RCNRB"). (*Id.*)

On December 21, 2012, New River filed several replacement schedules for its application.

On December 28, 2012, the Commission's Utilities Division ("Staff") filed a Letter of Sufficiency, stating that New River's application had met the sufficiency requirements outlined in A.A.C. R14-2-103 and that New River had been classified as a Class B utility.

On January 3, 2013, a Procedural Order was issued scheduling the evidentiary hearing in this matter to commence on September 9, 2013, and establishing other procedural requirements and deadlines.

On February 22, 2013, New River filed a Notice of Completion of Publication of Notice, including an Affidavit of Publication showing that notice had been published in the *Peoria Times*, a newspaper of general circulation in New River's service area, on February 8, 2013, and an affidavit stating that notice had been mailed to New River's customers on or about February 4, 2013.

On April 25, 2013, New River filed a copy of an application for approval of a Cross-Connection Tariff.[5]

On May 28, 2013, New River filed copies of customer comments that it had received concerning its rate application.

On June 26, 2013, Staff filed Staff's Notice of Filing Direct Testimony, along with the direct testimony of Crystal S. Brown, Staff Public Utilities Analyst V; Marlin Scott, Jr., Utilities Engineer; and John A. Cassidy, Public Utilities Analyst.

On July 17, 2013, New River filed a Request to Extend Deadline for Filing Rebuttal Testimony, requesting that its deadline be extended to July 22, 2013, and stating that Staff had agreed to the requested extension.

On July 18, 2013, a Procedural Order was issued granting New River's requested extension.

On July 22, 2013, New River filed Notice of Filing Rebuttal Testimony of Ray L. Jones, along with Mr. Jones's rebuttal testimony.

---

[5] The Cross-Connection Tariff had been filed on April 2, 2013, in Docket No. W-01737A-13-0087, and became effective by operation of law on May 2, 2013.

On August 12, 2013, Staff filed Staff's Notice of Filing Surrebuttal Testimony, along with the surrebuttal testimony of Ms. Brown, Del Smith,[6] and Mr. Cassidy.

On August 23, 2013, New River filed Notice of Filing Rejoinder Testimony of Ray L. Jones, along with Mr. Jones's rejoinder testimony.

On September 4, 2013, the Prehearing Conference for this matter was held at the Commission's offices in Phoenix, with New River and Staff appearing through counsel. At New River's request, it was determined that the first scheduled day of hearing, September 9, 2013, would be used for public comment only and that the evidentiary hearing would commence on the second scheduled day of hearing, September 12, 2013.

On September 5, 2013, Staff filed Staff's Notice of Filing Revised Surrebuttal Schedules, along with a set of revised schedules.

On September 9, 2013, the hearing convened solely for the receipt of public comment. New River and Staff appeared through counsel, and public comment was received from two individuals. Additionally, on that date, both Staff and New River filed their testimony summaries.

On September 12 and 13, 2013, the evidentiary hearing for this matter was held before a duly authorized Administrative Law Judge of the Commission at the Commission's offices in Phoenix, Arizona. New River appeared through counsel and provided the testimony of Mr. Jones. Staff appeared through counsel and provided the testimony of Mr. Smith, Mr. Cassidy, and Ms. Brown. At the conclusion of the hearing, New River requested to file one Late-Filed Exhibit ("LFE") and was directed to file another LFE. At the request of the parties, a briefing schedule was established that required initial briefs to be filed by October 25, 2013, and responsive briefs to be filed by November 8, 2013. The parties were advised that the extended deadline for the initial briefs would likely result in an extension of the timeframe for the Decision in this matter.

On September 30, 2013, New River filed Notice of Filing Affidavit of Ray L. Jones in Support of Late-Filed Exhibits, along with the expected LFEs.[7]

---

[6] Mr. Smith, Utilities Engineer Supervisor, provided Staff's surrebuttal testimony on engineering issues and sponsored Mr. Scott's direct testimony at hearing, as Mr. Scott had retired. (*See* Ex. S-7 at 1-2.)

[7] The LFEs included LFE Ex. A, Mr. Jones's affidavit; Att. 1, a City of Peoria zoning map; Att. 2, an enlargement of a portion of the zoning map; and Att. 3, a complete copy of the National Association of Regulatory Utility Commissioners ("NARUC") Uniform System of Accounts for Class A Water Utilities (1996) ("USOA").

On October 1, 2013, New River filed a Notice of Errata, including replacements for Att. 1 and Att. 2 of the prior LFE filing.

On October 21, 2013, a Procedural Order was issued extending the Commission's timeframe in this matter by 21 days due to the extended filing deadlines provided for the parties' briefs.

On October 25, 2013, Staff filed Staff's Opening Brief, and New River filed the Initial Closing Brief of New River Utility Company.

On November 8, 2013, Staff filed a Notice stating that Staff would not be filing a Reply Brief and instead would stand by its Opening Brief, and New River filed the Response Brief of New River Utility Company.

Between March 4, 2013, and October 29, 2013, approximately 89 customer comments were filed in this docket, some duplicates, and all but three expressing opposition to New River's requested rate increase. No requests for intervention were made in this matter.

III. APPLICATION & SUMMARY

New River's application reported the following:[8]

Adjusted FVRB:	$7,812,036
Adjusted Total Revenues:	$1,260,428
Adjusted Operating Expenses:	$1,256,799
Adjusted Operating Income:	$3,629
Current Rate of Return:	0.05%
Required Operating Income:	$681,210
Required Rate of Return:	8.720%
Operating Income Deficiency:	$677,580
Gross Revenue Conversion Factor:	1.6049
$ Increase in Gross Revenue Needed:	$1,087,457
% Increase in Gross Revenue Needed:	86.28%
Revenue Requirement:	$2,347,886

New River calculated its adjusted FVRB using an adjusted OCRB of $3,217,742 and an adjusted RCNRB of $12,406,330, giving each equal weight to reach its proposed FVRB of $7,812,036. (Jones Dir. at Sched. B-1.)

. . .

[8] *See* Jones Dir. at Sched. A-1, Sched. C-1.

New River determined its requested rate of return by reviewing rate orders recently issued by the Commission, rather than by conducting a cost of equity analysis. (Jones Dir. at 15-16.) Drawing from 10 Commission Decisions from 2012,[9] New River has proposed a 10.00-percent cost of equity, less a 1.280-percent fair value inflation adjustment, for an 8.72-percent fair value adjusted equity return. (*Id.* at 15.) New River has also proposed to use its actual 100-percent equity capital structure. (*Id.*)

New River's application showed that for the TY, 36.24 percent of New River's metered water revenue came from base charges, 28.93 percent came from first tier usage, 6.70 percent came from second tier usage, and 28.12 percent came from third tier usage. (Jones Dir. at Sched. H-2.) New River's application proposed a rate design intended to result in 35.96 percent of metered water revenues coming from base charges, 4.67 percent coming from first tier usage, 25.38 percent coming from second tier usage, and 33.99 percent coming from third tier usage. (*Id.*)

The rates proposed in New River's application would have increased the monthly bill for a residential customer served by a 5/8" x 3/4" meter, with average usage of 11,183 gallons, from $20.92 to $37.67, for an increase of $16.75 or 80.07 percent. (Ex. A-2 at Sched. H-4.) For a 1" meter residential customer with average usage of 16,126 gallons, the monthly bill would have increased from $38.93 to $76.61, representing an increase of $37.68 or 96.79 percent. (*Id.*)

As of the hearing in this matter, as a result of agreement on a number of adjustments, New River's position and Staff's position were as follows:[10]

	New River	Staff
Adjusted FVRB:	$6,729,925	$6,421,716
Adjusted Total Revenues:	$1,260,428	$1,260,428
Adjusted Operating Expenses:	$1,144,204	$1,043,695
Adjusted Operating Income:	$116,225	$216,733
Current Rate of Return:	1.73%	3.38%
Required Operating Income:	$586,849	$500,894
Required Rate of Return:	8.72%	7.80%
Operating Income Deficiency:	$470,625	$284,161
Gross Revenue Conversion Factor:	1.6187	1.63084

[9] Mr. Jones identified six different dockets, with equity returns averaging to 9.945 percent. (Jones Dir. at 16.) Two of the six identified dockets concerned utilities with capital structures like New River's, but the other four had capital structures including long-term-debt ratios ranging between 18.27 percent and 64.14 percent. (*Id.*)

[10] *See* Ex. A-4 at Sched. A-1 Rej.; Ex. A-6; Ex. S-3 at Rev. Surr. Sched. CSB-1.

$ Increase in Gross Revenue Needed:	$761,820	$463,422
% Increase in Gross Revenue Needed:	60.44%	36.77%
Revenue Requirement:	$2,022,249	$1,723,850

IV. RATE BASE ISSUES

New River and Staff currently propose the following for New River's FVRB:

	New River[11]	Staff[12]
Adjusted OCRB:	$2,576,573	$2,225,725
Adjusted RCNRB:	$10,883,277	$10,617,707
Adjusted FVRB:	$6,729,925	$6,421,716

The above positions reflect compromise and resolution of numerous rate base adjustments recommended by Staff and proposed by New River. Most notably, New River and Staff reached agreement on adjustments for post-TY plant, unrecorded plant, capitalization of expensed plant, plant reclassification, unrecorded plant retirements, contributions in aid of construction ("CIAC"), and amortization of CIAC. Cumulatively, the resolved rate base adjustments decreased New River's proposed FVRB by $1,082,111.

New River and Staff continue to disagree on four rate base issues: (1) whether to remove from rate base 100 percent of the value of plant in service for which New River was unable to supply supporting invoices ("inadequately supported plant"); (2) whether accumulated depreciation should be determined using the broad group model of depreciation or the vintage year group model of depreciation, a disagreement flowing from the need to address depreciation in the pumping plant account; (3) as a flow through issue, what amount to include in accumulated depreciation related to the inadequately supported plant; and (4) whether to allow New River to include working capital in rate base although New River did not complete a lead-lag study. (*See* Ex. A-6.) These issues are discussed separately below.

A. Inadequately Supported Plant

During its audit, Staff determined that New River was unable to supply supporting invoices for a total of $222,346[13] in plant included in its accounts for transmission and distribution mains, meters and meter installations, and power-operated equipment. (*See* Ex. S-1 at 12, Sched. CSB-4,

[11] Ex. A-4 at 4, Sched. B-1 Rej.
[12] Ex. S-3 at Rev. Surr. Sched. CSB-3.
[13] The exclusion for OCRB was $222,346, for RCNRB was $307,365, and for FVRB was $264,855. (Ex. S-2 at 6.)

Sched. CSB-6.) Staff has recommended that the entire unsupported amount be deducted from rate base and disallowed because a utility has an obligation, under Commission rules, to keep accounting records that reflect the cost of its properties and to keep all data needed to give complete and authentic information as to its properties.[14] (Ex. S-1 at 11-12.) Staff also has recommended removal of all of the accumulated depreciation associated with the inadequately supported plant.[15] (Tr. at 280-81; Ex. A-6.) At hearing, Ms. Brown explained that during an audit, performed using both Generally Accepted Accounting Standards ("GAAS") and the NARUC USOA, Staff verifies the existence of plant through invoices and canceled checks. (Tr. at 278.) Staff's verification of plant existence is done to ensure that plant amounts have not been recorded in error and that ratepayers are not paying for plant that is not actually serving them. (*See* Tr. at 279-80.) When the inadequately supported plant amount represents a large portion of a company's rate base (more than 10 percent), Staff considers treating all or a portion of the inadequately supported plant as CIAC. (Tr. at 280, 317.) In this case, Staff did not do so because the inadequately supported plant amount represents only a small percentage of New River's total plant in service (approximately 2 percent). (*Id.*; Ex. S-2 at 6.) Ms. Brown testified that Staff's typical disallowance for unsupported plant is 50 to 100 percent and that Staff has only made a disallowance as low as 10 percent for inadequately supported plant in one case involving Johnson Utilities,[16] in which Staff had received approximately 10 to 15 banker boxes of documentation from construction companies and had neither the time nor the manpower to trace all of the documentation to specific plant items. (Tr. at 319-21.) Ms. Brown testified that in most cases with inadequately supported plant, Staff receives no invoices whatsoever. (Tr. at 320.)

New River characterized Staff's position as "excessive and punitive" because the excluded amount initially was larger than the rate base that would be created by the plant, due to Staff's originally not making a corresponding adjustment for accumulated depreciation. (*See* Ex. A-3 at 4-5.) Mr. Jones testified that New River keeps tax depreciation schedules showing the plant, although

---

[14] Staff originally cited A.A.C. R14-2-610(D)(1) for this obligation, but subsequently clarified that the correct citation is A.A.C. R14-2-411(D)(1). (Tr. at 266.) Official notice is taken of the rule, which reads as follows: "Each utility shall keep general and auxiliary accounting records reflecting the cost of its properties, operating income and expense, assets and liabilities, and all other accounting and statistical data necessary to give complete and authentic information as to its properties and operations." (A.A.C. R14-2-411(D)(1).)

[15] Staff's adjustment was $61,265 for RCNRB, $46,966 for OCRB, and $54,116 for FVRB. (Ex. A-6.)

[16] The case involving Johnson Utilities was Docket No. WS-02987A-08-0180. (Tr. at 318.)

New River does not have a work order system such as a larger company might use to track and match plant items electronically. (Tr. at 129-30.) New River proposed that it would be more reasonable to exclude only 10 percent of the unsupported plant amount ($22,235 in original cost and $30,737 in reconstruction cost), which it characterized as "substantial." (Ex. A-3 at 5.) New River suggested that 10 percent was within the typical range of Staff's disallowance for inadequately supported plant, as evidenced by the 10-percent disallowance made in the case involving Johnson Utilities. (*See* Tr. at 318-21.) While New River did not make an adjustment for the accumulated depreciation corresponding to its proposed 10-percent disallowance for inadequately supported plant, characterizing such an adjustment as de minimis, New River indicated that it would not object to a corresponding adjustment made using Staff's methodology and acknowledged that the amount of Staff's corresponding accumulated depreciation adjustment was mathematically correct. (Tr. at 26-27.)

New River has an obligation to ensure that its records accurately reflect its plant in service, and it has acknowledged that its books have not been completely accurate in that regard.[17] The obligation for accurate recordkeeping exists in large part to protect ratepayers—from paying for plant that does not exist at all, from paying more than the cost of recorded plant, and from paying for plant that was contributed rather than purchased with equity. The NARUC USOA, with which the Commission's rules require compliance,[18] provides:

> Each utility shall keep its books of account, and all other books, records, and memoranda which support the entries in such books of accounts so as to be able to furnish readily full information as to any item included in any account. Each entry shall be supported by such detailed information as will permit a ready identification, analysis, and verification of all facts relevant thereto.[19]

The complete absence of required records to support the existence of the disputed plant makes the complete exclusion appropriate. This is not a case in which New River has presented Staff with

---

[17] In his prefiled direct testimony, Mr. Jones stated that "due to a lack of Company funds during the period of rapid growth for New River, items of plant were periodically constructed and funded by business entities controlled by Company management rather than by New River itself . . . [and] the costs of these items of plant funded by affiliates were not recorded on New River's books." (Jones Dir. at 7.) In light of these significant omissions or errors, it would not be surprising to discover that additional accounting errors had been made in New River's books.

[18] *See* A.A.C. R14-2-411(D)(2).

[19] NARUC USOA for Class A Water Utilities (1996) at 14 (included as Att. 3 to New River's LFE).

excessive records regarding the plant in question; nor is this a case in which New River's plant in service balance will be significantly reduced as a result of Staff's recommended adjustment.

Staff's recommendation to exclude 100 percent of the unsupported plant is reasonable and appropriate and will be adopted. It is also appropriate to adopt Staff's corresponding downward adjustment to accumulated depreciation for the inadequately supported plant,[20] and we will do so.

B. Depreciation Methodology

New River has been depreciating its plant accounts using a straight-line method, broad group procedure, and whole life technique ("broad group model"). (*See* Tr. at 99-101, 113, 136-38; Ex. A-21.) Staff has recommended that New River be required to depreciate its plant using a straight-line method, vintage year procedure, and whole life technique ("vintage year model"). (*See* Tr. at 282-83, 285-86.) The primary disagreement as to depreciation between New River and Staff centers around New River's use of the broad group model versus the vintage year model and New River's disagreement with the 12.5-percent depreciation rate required for the pumping equipment account under Decision No. 65134, issued in New River's last rate case.[21]

Mr. Jones explained that under the broad group model, individual assets lose their identity as individual assets once they become part of a group, and the group is depreciated as a whole, regardless of the underlying depreciation reserve that would exist for any of the assets that comprise the group if the assets were individually tracked. (Tr. at 136-38.) Although individual assets are not tracked for purposes of depreciation when the broad group model is used, when an asset in a group is retired, the asset is retired as if it were exactly 100 percent fully depreciated, regardless of how long the asset has actually been in service—whether one day or many years. (*Id.*) Mr. Jones testified that this retirement treatment is the "trade-off" for depreciating by group rather than by individual asset and that this keeps the group in balance and keeps any individual asset from being depreciated in excess of its original cost. (*Id.* at 138.) Mr. Jones agreed that it would be inequitable to ratepayers if a utility were permitted to recover more than the original cost of an asset. (*Id.* at 139.)

. . .

[20] Ex. S-6; Ex. S-3 at Rev. Surr. Scheds. CSB-11, CSB-17.

[21] Although the depreciation rate issue also concerns an operating expense adjustment, it is discussed here because of its impact on rate base. We note that Decision No. 65134 involved a Settlement Agreement.

In analyzing New River's accounts for purposes of this case, Mr. Jones determined that New River's pumping equipment account was "over-depreciated" as a result of the 12.5-percent annual depreciation rate for the pumping equipment account approved by the Commission in Decision No. 65134. (Ex. A-3 at 7.) Mr. Jones described the problem as over-accrual of depreciation expense, resulting in almost complete depreciation of plant for book purposes, although the plant has many years of useful life remaining. (Tr. at 94-95.) Mr. Jones referred to this as a "significant mismatch between recorded expense and actual expense" and stated that he and Staff disagreed both as to the cause and the appropriate remedy. (Id.) Mr. Jones asserted that the composite average service life for pumping equipment is approximately 20 years, much longer than the eight years corresponding to the 12.5-percent rate, and that a rate of 5 percent would have been appropriate based on this composite average service life.[22] (Ex. A-3 at 7-8; Ex. A-4 at 7.) According to Mr. Jones, as a result of the 12.5-percent depreciation rate, all of the pumping equipment at New River's booster stations and wells, originally placed in service between 1997 and 2002, was fully depreciated as of 2010, although the equipment has many more years of useful life remaining. (Tr. at 9.) Mr. Jones described this as "a mismatch between the recorded depreciation expense associated with a depreciable asset and the actual loss in service value incurred." (Ex. A-4 at 6.)

Mr. Jones proposed a three-step approach to remedy the over-depreciation of New River's pumping equipment account: (1) significantly lower the depreciation rate for the account on a going-forward basis to make it more consistent with the lives of the underlying plant; (2) reset the depreciation base on which the annual depreciation expense is calculated, by switching to a vintage year model for this specific account only, to bring the annual depreciation expense more in line with the true annual cost of service and to prevent over-depreciation of newly constructed assets; and (3) address the historic over-depreciation in the account by restating the accumulated depreciation for all pumping equipment added since the end of New River's last test year (December 31, 2000), using a 5-percent depreciation rate. (Ex. A-3 at 10-12.) Based on this three-step approach, New River

[22] Mr. Jones testified that in the pumping equipment account, it is only the pumps themselves that have a relatively short life—approximately five to twelve years—while the other plant items (e.g., piping, valves, motors, and motor control centers and wiring) have lives that are much longer (40 years, 10 to 40 years, 10 to 20 years, and 15 to 40 years, respectively). (Tr. at 8.)

proposed to decrease accumulated depreciation by $140,444 for purposes of calculating OCRB, by $0 for RCNRB, and by $70,222 for FVRB. (Ex. A-4 at 5-6; Ex. A-6.) New River also proposed an 8-percent depreciation rate for the pumping equipment account going forward, based on an estimated composite remaining life of 12.5 years for the remaining vintage years. (Ex. A-3 at 13.) This resulted in a proposed TY depreciation expense of $24,117 for the pumping equipment account, which Mr. Jones stated was well below the true annual cost, which he calculated to be $48,946.[23] (Ex. A-3 at 13; Ex. A-4 at Sched. C-2 Rej. At 15.)

At the surrebuttal stage, Staff initially recommended that a 5-percent depreciation rate be adopted for the pumping equipment account, both for calculation of the TY depreciation expense and going forward. (*See* Ex. S-7 at 3; Ex. S-2 at 11.) In response, New River stated that the 5-percent depreciation rate had been based on an analysis of the pumping equipment account at the time of the prior rate case and would not be appropriate to adopt in this case because the 5-percent depreciation rate does not take into account intervening depreciation or the recommendations, by both New River and Staff, that the vintage year model should be used for the pumping equipment account. (Ex. A-4 at 13-14.) Mr. Jones asserted that the 8-percent rate would be the appropriate rate to adopt in this case if accumulated depreciation were also restated as he proposed, but that the 12.5-percent rate would be the appropriate depreciation rate to adopt for the pumping equipment account if his adjustment to accumulated depreciation were not adopted. (*Id.* at 14.)

Staff's revised surrebuttal schedules used the existing 12.5-percent depreciation rate for the pumping equipment account, both for calculation of the TY depreciation expense and going forward. (*See* Ex. S-3 at Rev. Surr. Sched. CSB-37.) Staff also opposed New River's proposal to restate accumulated depreciation for the period from the end of New River's last test year (December 31, 2000) to the end of the instant rate case's TY, with Ms. Brown stating the following:

. . .

. . .

. . .

[23] Mr. Jones stated that this would have been the depreciation expense in this case if New River had been authorized to use a 5-percent depreciation rate for pumping equipment in its last rate case. (Ex. A-3 at 11.)

> The Commission in Decision No. 65134 authorized a 12.5 percent depreciation rate for account no. 311, Pumping Equipment. Consequently, this depreciation rate is the only rate that the Company could utilize to recover the annual depreciation of its pumping equipment until the Company receives a different depreciation rate from the Commission. Since the Company has recovered the cost from customers using the Commission authorized 12.5 percent rate and has recorded the annual pumping equipment depreciation expense in the related accumulated depreciation plant account, it would be in violation of the Commission's Decision No. 65134, and sound accounting and ratemaking principles, to restate the accumulated depreciation for pumping equipment using the five percent rate.[24]

Staff recommended that accumulated depreciation be adjusted only for pumps that became fully depreciated the same year they were placed in service, using the authorized 12.5-percent depreciation rate and the number of interim years. (*See* Ex. S-3 at Rev. Surr. Sched. CSB-11, CSB-17.) This adjustment decreased accumulated depreciation for OCRB by $38,081 and for RCNRB by $45,130. (*See id.*) Staff also adjusted accumulated depreciation to reflect retirements. (*See id.*)

Ms. Brown asserted that, contrary to Mr. Jones's testimony, the depreciation over-accrual problem for the pumping equipment account was attributable to New River's use of the broad group model, which she characterized as problematic in general, harmful to ratepayers, and potentially harmful to utilities.[25] (*See* Ex. S-1 at 19-25.) Staff recommended that New River be required to use the vintage year model. (Ex. S-2 at 14.) Ms. Brown stated that with the vintage year model, assets are considered to be fully depreciated once the full cost of the vintage group has been recovered through depreciation expense, and fully depreciated assets that remain in service are no longer depreciated. (Ex. S-1 at 20.) According to Ms. Brown, the vintage year model is consistent with the

---

[24] Ex. S-2 at 11.

[25] Ms. Brown asserted that the following problems can arise when a regulated utility uses the broad group model: (1) if plant remains in service longer than anticipated, a plant group may be depreciated beyond its original cost, causing a negative net plant balance for the group, which reduces rate base; (2) if a cap is placed on accumulated depreciation for a plant group to prevent the group's net plant balance from going negative, depreciation expense is not recorded in accumulated depreciation each year, which violates the NARUC USOA, causes rate base to be overstated, and causes ratepayers to pay depreciation expense without the associated accumulated depreciation being reflected in the utility's books; (3) if the cost of an asset is not removed from a plant account when the asset is taken out of service, depreciation expense related to the book cost of the asset will continue to accrue indefinitely (as occurred with New River's pumps that had been replaced or rebuilt but not removed from the pumping equipment account) because the asset will still be part of the group, and the broad group method does not keep track of individual assets; (4) if a single plant account balance is very high, any addition to the plant account group that is smaller in value than the annual depreciation expense for the group will become fully depreciated in a period much shorter than the addition's service life, violating the matching principle and the NARUC USOA; and (5) if full depreciation occurs prematurely because a plant account has a large balance, cash flow will likewise decrease prematurely. (Ex. S-1 at 21-25.)

matching principle, the NARUC USOA, and the accepted ratemaking principle that only the cost of an asset should be recovered through rates. (Ex. S-1 at 20.)

Ms. Brown compared this to the broad group model, which she stated allows depreciation expense to be calculated for an asset as long as the asset is in service, regardless of whether depreciation amounting to or exceeding the full cost of the asset has already been recovered for the asset. (Ex. S-1 at 20.) Ms. Brown testified that the vintage year model is designed to correct that "flaw" in the broad group model and further asserted that continuing to depreciate an asset that has already been fully depreciated is not consistent with the NARUC USOA, which discusses only straight line depreciation and allows only for the service value (or original cost) of an asset to be depreciated through equal annual charges during the asset's useful life. (*Id.*; Ex. S-1 at 21 (citing NARUC USOA).[26])

The Commission's rules require a water utility to maintain its books and records in conformity with the NARUC USOA. (A.A.C. R14-2-411(D)(2).) The NARUC USOA requires that depreciation charges be computed using either the straight-line remaining life method or the straight-line method, as approved by the Commission, unless composite depreciation rates have been approved. (NARUC USOA[27] at 36.)

The Commission's rules further require that all public service corporations maintain adequate accounts and records related to depreciation practices, that annual depreciation accruals be recorded, that a separate reserve for each account or functional account be maintained, and that the cost of depreciable plant adjusted for net salvage be distributed in a rational and systemic manner over the estimated service life of the plant. (A.A.C. R14-2-102(B); A.A.C. R14-2-411(D)(2).) In the Commission's rules, "depreciation" is defined to mean "an accounting process which will permit the

---

[26] Ms. Brown acknowledged that the NARUC USOA does not actually discuss either the broad group model or the vintage year model, but stated that the broad group model is unacceptable under the NARUC USOA because allowing a plant item to be depreciated beyond its original cost is inconsistent with straight-line depreciation. (Tr. at 361-63, 374-75.) Ms. Brown also acknowledged that she is unaware of any prior Commission decision prohibiting utilities from using the broad group model. (Tr. at 376.)

[27] As previously noted, the NARUC USOA for Class A Water Utilities (1996) was provided as a LFE by New River. The NARUC USOA definitions of the two different straight-line methods vary only in that one speaks to correcting depreciation rates to reflect changes in estimates of "future life and salvage" and the other to correcting depreciation rates to reflect changes in estimates of "service life and salvage." (*Id.* at 13.) For our purposes, these distinctions are not helpful.

recovery of the original cost of an asset less its net salvage over the service life," and "accumulated depreciation" is defined to mean "the summation of the annual provision for depreciation from the time that the asset is first devoted to public service." (A.A.C. R14-2-102(A).) The rules permit a public service corporation to seek a change in a depreciation rate in a rate case and require the public service corporation seeking such a change to provide "[d]ata and analyses supporting the change . . . , including engineering data and assessment of the impact and appropriateness of the change for ratemaking purposes." (A.A.C. R14-2-102(C).)

In defending its current and proposed broad group model, New River stated that none of its plant account groups have accumulated depreciation balances exceeding the original cost of the plant. (*See, e.g.,* Ex. A-4 at 8.) Staff asserted that this was true only because New River had imposed a cap on depreciation rather than allowing accrual to continue on an annual basis. (Tr. at 286.) New River disputed Staff's assertion that depreciation had been capped, stating that Staff's focus on any individual plant item "demonstrate[d] a fundamental lack of understanding of depreciation using a group procedure." (*See* Ex. A-4 at 7; Resp. Br. at 7.) New River did not explain how it was able to ensure that no asset was depreciated in excess of its original cost, particularly without considering the individual assets in the group.

Even if we were to assume the validity of New River's assertions that the broad group model renders impossible the type of depreciation over-accrual about which Ms. Brown expressed concern, we are not convinced that it is in the public interest or New River's ratepayers' interests for New River to continue using the broad group model for depreciation. New River has demonstrated a lack of precision in its recordkeeping, even in terms of accounting for the existence of physical plant, and the broad group model easily lends itself to overstating the remaining cost of a plant group and thus overstating depreciation expense, particularly when New River fails to properly record and make adjustments for retirements. To the extent that depreciation is accrued in excess of the original cost of plant, and rates are not adjusted downward to compensate, a company has the potential to over-earn.

Additionally, New River is proposing that its pumping equipment account be singled out and depreciated differently than all of its other accounts, using the vintage year model. Special

depreciation treatment for one account has the potential to increase confusion and to increase New River's existing and acknowledged difficulty in keeping accurate accounts. New River's proposal also suggests that New River recognizes the problems associated with the broad group model and that they can be improved by using the vintage year model. New River's proposal to use the vintage year model for only the pumping equipment account also suggests that New River has found the balance between the broad group model and its retirement "trade-off" to be disadvantageous for New River, at least for the pumping equipment account, and has proposed use of a different depreciation model for that account rather than accepting that the balance does not always weigh in its favor.

We also note that, while New River has asserted "regulatory integrity [would be] maintained"[28] if New River were permitted to restate accumulated depreciation for all plant added to the pumping equipment account after the end of the prior test year (December 31, 2000), such a restatement would not be consistent with Decision No. 65134's requirement for New River to use a 12.5-percent depreciation rate for the pumping equipment account on a going forward basis.[29] (Decision No. 65134 at 10, Ex. B.) It also would not address New River's having already accrued the depreciation and collected the depreciation expense in rates in the intervening years.

The Commission has the authority, under A.R.S. § 40-222 as well as its exclusive and plenary constitutional ratemaking authority, to prescribe depreciation methodology. Staff's recommendations—to retain the 12.5-percent depreciation rate for the pumping equipment account, not to restate the accumulated depreciation balance for the pumping equipment account using a depreciation rate other than the 12.5-percent depreciation rate authorized in Decision No. 65134, and to require New River to implement the vintage year model for depreciation of all of its plant accounts going forward—are consistent with the straight-line method required by the NARUC USOA and will result in a rational and systemic depreciation methodology consistent with the Commission's rules. The consistency of Staff's recommended methodology should minimize the confusion and potential problems that could occur with the unique and singular plan advocated by New River to use the vintage year model only for the pumping equipment account. We will adopt Staff's

[28] Ex. A-3 at 12.

[29] We also note that restating accumulated depreciation using the lower requested depreciation rate would result in $140,444 less accumulated depreciation for the TY and thus higher plant in service and a higher rate base.

recommendations for adjustments to accumulated depreciation, for depreciation rates, and for the depreciation model to be used by New River going forward.

C. Depreciation for Inadequately Supported Plant

As discussed above, because we are adopting Staff's position as to inadequately supported plant, it is necessary and appropriate to adopt the corresponding adjustment to accumulated depreciation. New River agreed with Staff's calculation method for the accumulated depreciation adjustment and with the outcome of Staff's calculation.

D. Working Capital

New River has proposed that it be permitted to recover a cash working capital allowance of $95,338, which it determined using the formula method rather than a lead-lag study. (Ex. A-4 at 8-9; Tr. at 130.) New River argued that it is a relatively small utility, that lead-lag studies are complicated and cost prohibitive, and that the Commission is considering an update to the classification rule for utilities that could result in modification of New River's classification as a Class B utility. (New River Resp. Brief at 8-9.)

Staff has recommended that New River's requested cash working capital allowance be denied because New River did not complete a lead-lag study, and the Commission typically allows cash working capital for a utility of New River's size only if a lead-lag study justifying such allowance has been completed. (Ex. S-2 at 17-18.) Ms. Brown explained that while a utility's cash working capital requirement can be positive or negative, depending on when revenues are received and operating expenses paid, and thus could increase or decrease rate base, the formula method always yields a positive result because it assumes a revenue lag. (*Id.*) Staff recommended total disallowance of cash working capital. (*Id.*)

The Commission, as a rule, does not allow utilities with New River's level of revenue to recover cash working capital without establishing through evidence, such as a lead-lag study, that the utility experienced a revenue lag necessitating the cash working capital. New River has not produced evidence to establish either that it experienced a revenue lag or that the Commission should alter its general policy by allowing cash working capital in this matter. Staff's recommendation to disallow cash working capital is reasonable and appropriate and will be adopted.

E. Fair Value Rate Base Summary

Based on the discussion of rate base issues set forth above, we determine New River's rate base to be the following:

Adjusted OCRB:	$2,225,725
Adjusted RCNRB:	$10,617,707
Adjusted FVRB:	$6,421,716

V. OPERATING INCOME

A. Test Year Revenues

New River and Staff have essentially agreed on TY revenues, with New River proposing TY revenues of $1,260,429 and Staff recommending TY revenues of $1,260,428. (Ex. A-6.) We will adopt herein a TY revenues figure of $1,260,428, consistent with the total for the two components of TY revenue provided by New River. (*See* Ex. A-1 at Sched. C-1.)

B. Test Year Operating Expenses

The following total adjusted operating expenses for the TY have been proposed by New River and recommended by Staff:

New River	Staff	Difference
$1,144,204	$1,043,695	$100,509

These figures reflect New River's agreement to a number of expense reclassifications recommended by Staff as well as Staff's recommended expense adjustments related to arsenic media replacement, contract accounting services, contract legal services, water testing expenses, affiliate legal costs, affiliate transportation expenses, miscellaneous expenses, and interest on customer deposits.

The parties have not reached agreement on New River's proposed adjustment to Salaries and Wages Expense; on a corresponding adjustment to Taxes Other Than Income Expense; or on Staff's recommended adjustments to reduce Repairs and Maintenance Expense, Building Rents Expense, Vehicle Rent Expense, Transportation Expense, and Bad Debt Expense. Due to their different positions pertaining to FVRB, the parties have also proposed different Depreciation Expense

figures.[30] Finally, although the parties have agreed on the methodology to determine Income Tax Expense, Staff has recommended Income Tax Expense significantly higher than that proposed by New River.

Each area of disagreement is discussed below.

1. Salaries and Wages

Based upon her review completed for this case, Ms. Brown identified the following areas in which New River had failed to keep its books and records in compliance with the NARUC USOA:

1. Missing or inadequate documentation to support plant costs[;]
2. Expenses being recorded in the wrong account[;]
3. Expenses of the owner, Mr. Fletcher, and the affiliate Cody Farms sometimes being included in New River's expenses[;]
4. Shared assets not allocated properly[;]
5. Unrecorded Depreciation Expense[;]
6. Unrecorded plant[;]
7. Unrecorded retirements[;]
8. AIAC's that had not been approved by the Commission[;]
9. Unrecorded AIAC[; and]
10. AIAC's that were not transferred to CIAC following the terms of the AIAC contract[.][31]

As a result, Staff has recommended that New River be required to file, within 60 days after the date of the decision in this matter, for Staff approval, a plan describing the actions New River will take to maintain its books and records in compliance with the Commission's recordkeeping rule[32] and the NARUC USOA. Staff has recommended that the plan include (1) training on the recordkeeping requirements of A.A.C. R14-2-411(D)(1), (2) implementation of policies and procedures to help ensure that source documents such as invoices and canceled checks are maintained to support plant costs and not destroyed or thrown away, and (3) training on recording AIAC in accordance with the NARUC USOA. Additionally, Staff has recommended that New River use work orders when recording retirements and that each retirement work order include the following information: (1) whether the retirement cost used is actual or estimated, (2) the name of the water company or system from which the plant was removed, (3) the date of retirement, (4) the NARUC account number from which the plant was removed, (5) the reason for retirement, and (6) appropriate approvals for the

---

30 As stated previously, the Commission is adopting Staff's position on Depreciation Expense.
31 Ex. S-1 at 49.
32 Staff cited A.A.C. R14-2-610(D)(1) in error. As noted previously, the correct citation is A.A.C. R14-2-411(D)(1).

retirement. (Ex. S-1 at 49-50.)

New River has stated that it agrees with and supports Staff's recordkeeping-related recommendations, but that New River will need a dedicated accounting analyst to track and address its accounting issues on a daily basis, as its current five staff members are a "very lean" staff for a utility that serves nearly 3,000 customers. (*See* Ex. A-3 at 20-21; Tr. at 28-29, 163-64, 171-72.) New River has proposed increasing TY Salaries and Wages Expense by $45,000 to cover the cost for the new accounting analyst position it desires to create.[33] (Ex. A-3 at 20.) Mr. Jones stated that this new position is necessary for New River to comply with Staff's recommendations for New River to improve its recordkeeping.

Staff has recommended denial of the additional expense proposed to add a new accounting analyst because, Staff asserted, it would be more cost efficient for New River to provide its existing employees additional training in proper recordkeeping. (Ex. S-2 at 19.) Staff also asserted that hiring a new employee would not resolve the existing recordkeeping issues and that this proposed addition to Salaries and Wages Expense represents a cost that is not known and measurable because the costs were not incurred during the TY and no steps have been taken to advertise or fill such a position. (*Id.*; Tr. at 291.)

New River argued that Staff's objection is unfair because the request for additional revenue to cover a new accounting analyst was made specifically in response to Staff's recommendations in this case. (Resp. Br. at 9-11.) New River also argued that, due to his extensive work with water utilities, Mr. Jones is qualified to provide a reliable estimate of the annual cost of the accounting analyst position that he has recommended New River create and fill. (*Id.*)

At hearing, Mr. Jones testified that New River's accounting and recordkeeping problems stem both from a lack of training or knowledge and from New River's being understaffed as compared to other utilities of comparable size. (Tr. at 163-64.) According to Mr. Jones, primary responsibility for keeping New River's books on a day-to-day basis falls to Karen Fletcher, who gets some assistance from the customer service representative and also relies on New River's outside accountants for

[33] New River proposed a corresponding adjustment to increase taxes other than income.

support. (Tr. at 164.) Mr. Jones did not believe that either Mrs. Fletcher or the customer service representative had completed any utility accounting training, and also believed that none of the outside accountants specialize in utility accounting. (Tr. at 164.) Mr. Jones recommended that New River only hire an accounting analyst who already has utility experience and, additionally, recommended that some on-site, hands-on training at New River be conducted by someone such as himself.[34] (Tr. at 165.) Mr. Jones asserted that he expected the accounting analyst would, over time, attend trainings sponsored by NARUC or Public Utilities Reporting as well. (*Id.*)

While New River clearly needs to improve its accounting and recordkeeping practices, as perhaps evidenced most obviously by its complete lack of records for some plant (and expenses, as discussed below), but also by its somewhat loose classification of expenses, New River has not established that its current staff is insufficient or incapable of learning and following NARUC USOA and Commission requirements. Nor has New River provided evidence establishing that it would be able to hire a qualified accounting analyst at all or for its proposed $45,000 salary. The proposed expense for an accounting analyst is at this time completely speculative—*i.e.,* not known and measurable. New River has not established that it intends to hire such an employee.[35] Nor is it possible at this time for anyone to determine whether New River would be able to hire such an employee or for how much, when that would occur, or how such an employee's hiring might impact other expenses, if at all.[36]

Mr. and Mrs. Fletcher are well compensated both as employees of New River—collecting $210,000 in salaries and $22,325.80 in medical expense reimbursements between them for the TY—and as the owners of Cody Farms—collecting rent for various properties used by New River. As the owners and managers of New River, the Fletchers are responsible for its operations and have a duty to ensure that New River's accounts and records are kept in compliance with the NARUC USOA and Commission bookkeeping and recordkeeping requirements. New River is already paying its

---

[34] Mr. Jones appears to have a direct financial interest in the adoption of this recommendation.

[35] Mr. Jones did not and cannot make this commitment for New River. He has simply made the recommendation.

[36] For example, having another staff member might impact the work hours and compensation for other staff members or the expenses associated with their work. For the TY, New River claimed $77,200 for salaries and wages and $210,000 for salaries and wages for officers and directors, and Staff recommended no adjustment to those expenses. (*See* Ex. S-1 at Sched. CSB-21.)

employees to do its bookkeeping and accounting, although these tasks are not being done correctly. If New River's current employees are incapable of performing those necessary tasks competently, New River either needs to ensure that its employees receive the additional training necessary to perform those tasks competently, or New River needs to replace its current employees with competent employees. In addition, as New River has not been using the services of an outside accountant with experience in regulatory utility accounting, as part of its improvement plan, New River should be required to explore the possibility of obtaining such services going forward, at least on a periodic basis. Such efforts could result in more streamlined rate cases in the future, in fewer disallowances of plant and expenses, and in cost savings both in legal fees and consulting fees.

As a result, approving the expense would not be just and reasonable, and Staff's recommended disallowance will be adopted. Staff's recommendations for a bookkeeping and recordkeeping improvement plan, and for New River to use a work order system to record retirements,[37] are just and reasonable and will be adopted.

2. Repairs and Maintenance

New River and Staff have disagreed on two different adjustments to repairs and maintenance expense, each of which will be dealt with separately.

a. Inadequately Supported Credit Card Charges

In its application, New River proposed TY repair and maintenance expenses that included $27,584 in charges made using a credit card issued to Mr. Fletcher personally. (*See* Ex. A-3 at 18; Tr. at 322-23.) The credit card statements submitted to Staff to support the expenses were largely redacted to exclude charges Mr. Fletcher identified as personal expenses. (Tr. at 157.)

When Staff requested that New River provide the underlying invoices to support the remaining credit card purchases claimed as New River expenses, New River asserted that the underlying records had not been retained and could not be produced. (Tr. at 122-23.) Instead, New River provided copies of credit card statements that included the charges. (Tr. at 292.) Ms. Brown testified that Staff normally would have disallowed all of the charges because of the lack of

[37] The NARUC USOA actually requires work orders to be used for plant retirements. (*See* NARUC USOA at 34.)

underlying invoices, but that Staff decided to give New River "the benefit of the doubt" and accept the credit card statements as supporting documents. (*Id.*) Ms. Brown reviewed the redacted credit card statements and recommended disallowance of transactions that she determined not to be necessary expenses for the provision of service (*e.g.*, charges at L'auberge de Sedona hotel, Berean Christian Stores, Ulta, and Hobby Lobby) or for which the location of the transaction was partially or completely redacted.[38] (Ex. S-1 at 34-35.) The charges left after Ms. Brown's disallowances totaled $9,328 and were made in the Phoenix area at merchants such as Home Depot, Lowe's, Harbor Freight, and the U.S. Postal Service. (*Id.* at 35-36.) Staff recommended that the $9,328 be divided and allocated three ways, with one-third allocated to New River, one-third allocated to Cody Farms, and one-third allocated to Mr. Fletcher personally. (Tr. at 293.) Ms. Brown stated that this was done because Staff considered the credit card purchases to have been related party transactions, New River had included some costs for its owners and Cody Farms in its operating expenses, and New River had not produced invoices to support the credit card purchases. (Ex. S-1 at 36.) As a result, Staff recommended that only $3,109 of the charges be allowed in TY expenses. (Tr. at 325.) Staff has further recommended that New River not be permitted recovery in the future for credit card charges that are not supported by underlying invoices. (Ex. S-1 at 36.)

New River accepted Staff's reduction of the credit card expenses to $9,328, but has disputed Staff's additional allocation of $6,219 of the credit card charges to Mr. Fletcher and Cody Farms. (Ex. A-4 at 10.) New River asserted that no evidence supports the allocation of $6,219 to Mr. Fletcher and Cody Farms rather than to repairs and maintenance expense for New River and that the three-way allocation is excessive, arbitrary, and unnecessarily punitive. (*See id.*; Tr. at 157-58; Init. Br. at 12-13.) Mr. Jones testified that, to his knowledge, only personal expenses and New River expenses had been charged on the card; he had no knowledge that any of the expenses were incurred on behalf of Cody Farms and did not know whether Mr. Fletcher had a separate credit card for Cody Farms. (Tr. at 121-23.) Mr. Jones also testified that New River now has its own separate credit card to be used exclusively for company business. (Tr. at 158.)

---

[38] Ms. Brown noted that some of the charges had been made in Cottonwood and Morenci, Arizona, and in Odessa, Texas. (*Id.* at 35.)

New River included within its requested Repairs and Maintenance Expenses charges made on Mr. Fletcher's personal credit card for items that clearly were not properly categorized as business expenses—most notably charges for a hotel in Sedona and at a beauty supplies store. It is neither surprising nor unreasonable for Staff to conclude, in light of the inclusion of such charges, and particularly because of the absence of supporting receipts, that some portion of the charges made at more appropriate merchants might also be attributable either to the Fletchers personally or to Cody Farms. New River argued that Staff had no evidence to support such a conclusion. Yet, New River had the burden of proof to establish the charges as valid utility expenses for which recovery should be permitted. New River failed to do so. This is one example of why New River must improve its bookkeeping and recordkeeping practices—to ensure that it is able to meet its burden of proof in rate cases. As previously noted, the Commission's rules and the NARUC USOA require a utility to keep records to support every entry in its books so that full information as to any item in any account can be readily furnished and each entry is supported by detailed information permitting ready identification, analysis, and verification of all facts relevant to it. (NARUC USOA at 14.) Because New River was unable to support the expenses with invoices, and because New River has not been careful to segregate the operating expenses of New River from the Fletchers' personal expenses and Cody Farms' operating expenses (as discussed in more detail below), a complete disallowance of these expenses would not be unreasonable. However, because New River has demonstrated that certain charges were made at merchants at which appropriate operating expenses could be incurred, because New River has maintained that the remaining expenses represent New River operating expenses, and because Staff has supported allowance of a portion of these expenses, the Commission, in its discretion, will allow $3,019 of these expenses as just and reasonable TY Repairs and Maintenance Expenses. The Commission will also put New River on notice that recovery will not be permitted in the future for credit card charges for which New River is unable to provide underlying documentation establishing the merchant, the items purchased, and that the expense was reasonably necessary for the provision of service.

. . .

. . .

b. Tank Painting

New River has proposed to include $31,333 in normalized TY tank painting expenses, pursuant to a plan to have all of New River's steel storage tanks painted within the next six years at a total cost of $470,000, which would be amortized over a 15-year period. (*See* Tr. at 29-30; Ex. A-3 at 18-19; Ex. A-4 at 10-11.) New River asserted that the recovery of tank recoating costs is critical because New River's tanks are at or approaching the age when they require their first recoating. (Jones Dir. at 12.) New River also stated that the storage tank and hydropneumatic tank at the 78th Lane Booster Plant were due for recoating in 2012, but that New River was forced to postpone the recoating due to insufficient available funds. (*Id.*) To support its request, New River provided a copy of a written proposal prepared by Arizona Coating Applicators Inc. ("ACAI") on May 2, 2013, in which ACAI proposed to clean and paint the exterior and to clean, paint, and disinfect the interior of one 106' x 16' existing water tank (built and last painted in 1997) for the quoted price of $130,000. (Ex. A-20.) ACAI's proposal stated that the quote was valid for 90 days. (*Id.*) Mr. Jones testified that the ACAI proposal was for the storage tank at the 78th Lane Booster Plant and that Mr. Fletcher had called ACAI's president on May 7, 2013, and accepted the proposal for the work to be done in winter 2013, when the weather cooled, as indicated by a notation written by Mr. Fletcher on the ACAI proposal. (*See* Tr. at 116-18, 123-24; Ex. A-20.) Mr. Jones testified that, based on his management experience, he believed there was a contract between Mr. Fletcher and ACAI to have the recoating work done. (*See* Tr. at 123-24.) Mr. Jones testified that because New River plans to have all of the tanks repainted within six years, and to obtain recovery of the expenses over 15 years, New River will be expending $313,335 more for tank painting in the first six years than it would recover in those same six years, and New River would not be made whole until 2027. (Ex. A-4 at 10-11.)

Staff has recommended that the proposed expense be denied because it is not a historical cost, the amount is not known and measurable, and Staff believes that the cash flow recommended by Staff would provide enough revenue for New River to complete the tank painting without inclusion of the proposed pro forma expense adjustment. (Tr. at 293.) Ms. Brown stated that if recovery were allowed for the $130,000 in work described in the ACAI proposal, it "would be tantamount to single-

item ratemaking where the expense is not properly matched to the expenses of the same period," because only the tank painting expense would be considered, not any reductions in other expenses or any changes in revenues in 2013. (*Id.* at 294.) Ms. Brown stated that the "mismatch would not necessarily be fair to ratepayers." (*Id.*) Ms. Brown also stated that she believed the reason New River sought recovery for this future expense is because New River's owners have taken all of the money out of New River. (*See* Tr. at 315-16.) Staff did not dispute that water tanks need to be recoated approximately every 15 years or that New River's water tanks need to be recoated and did not dispute the reasonableness of the $130,000 cost included in the proposal made by ACAI. (Tr. at 192-94, 314, 329.)

On brief, New River argued that the Commission had recently allowed recovery of normalized tank recoating expenses, based upon cost projections, for Arizona-American Water Company's Agua Fria Division in Decision No. 73145.[39] (Resp. Br. at 17.) New River asserted that it was requesting "the very same normalized tank recoating expense in this case." (*Id.*) We do not find this argument compelling, considering that Decision No. 73145 involved Commission approval of a Settlement Agreement and did not include any findings of fact regarding normalized tank recoating expense.[40] (*See* Decision No. 73145.)

While the Commission's rules require a utility to use a historical test year for its rate case, they also allow for pro forma adjustments to actual test year figures "to obtain a normal or more realistic relationship between revenues, expenses and rate base." (*See* A.A.C. R14-2-103(A)(3)(i), App. C.) The Commission allows such adjustments to be made for future expenses when there is evidence establishing that the future expenses are known and measurable. In this case, the evidence establishes that New River has an obligation to incur a $130,000 expense for tank painting to be commenced in the next few months.[41] The evidence also establishes that this is a reasonable level of

---

[39] Official notice is taken of Decision No. 73145 (May 1, 2012).

[40] Additionally, we note that Decision No. 73145 included as a finding of fact that "[n]one of the positions taken in th[e] Agreement by any of the Parties may be referred to, cited, or relied upon as precedent." Decision No. 73145 at 22 (quoting Settlement Agreement at § 6.l(d)).

[41] *See, e.g., K-Line Builders, Inc. v. First Federal Savings & Loan Assoc.,* 139 Ariz. 209, 677 P.2d 1317 (Ariz. Ct. App. 1983), of which official notice is taken. In K-Line Builders, the Court of Appeals stated the following concerning formation of an oral contract:

> For an enforceable contract to exist, there must be an offer, an acceptance, consideration, and sufficient specification of terms so that obligations involved can be

expense for the work to be completed, that New River's tanks need to be recoated, and that a 15-year period between recoatings for water tanks is reasonable. Based upon the evidence herein, we find that it is just and reasonable to allow New River recovery of the $130,000 in tank recoating expense for the work to be completed by ACAI, with the $130,000 to be normalized over 15 years, which amounts to a pro forma expense increase of $8,667 for the adjusted TY. We will require New River to ensure that the tank recoating work is completed in accordance with its testimony herein and to file, as a compliance item in this docket, no later than June 2, 2014, documentation from ACAI confirming completion of the quoted tank recoating work.

3. Rent, Buildings

New River and Staff have not reached agreement on the annual rent that should be allowed for three separate properties owned by Cody Farms and rented by New River: an office building, the 87th Avenue Booster Plant property ("87th Ave. property"), and a portion of a workshop facility. In its application, New River included no rent for these properties, instead including $75,000 in TY "management fees" paid to Cody Farms. (Jones Dir. at Sched. C-1.) New River subsequently clarified that Cody Farms provides no management services to New River and that Cody Farms merely charges New River rent for the use of Cody Farms' properties, with the Fletchers collecting that rent. (Tr. at 126-27.) According to Mr. Jones's testimony, in preparation for the TY, and based on advice received from legal counsel, Mr. Fletcher prepared a handwritten schedule establishing the amounts New River should pay Cody Farms for the use of Cody Farms' properties, which totaled $75,000. (Tr. at 145-46.) Mr. Fletcher used this breakdown to respond to data requests from Staff. (*Id.*) New River did not provide any evidence of written lease agreements related to New River's use of Cody Farms' properties, and Mr. Jones indicated that the deals between Cody Farms and New River are not written. (*See, e.g.,* Tr. at 151.)

New River has asserted that it should be permitted to recover TY rent expense of $48,600 for

---

> ascertained. . . . The offer creates a power of acceptance permitting the offeree by accepting the offer to transform the offer as promised into a contractual obligation. . . . .
>
> An acceptance is "... a manifestation of assent to the terms thereof made by the offeree in a manner invited or required by the offer.
>
> . . . A promise for a promise is adequate consideration.

139 Ariz. at 212, 677 P.2d at 1320 (citations omitted).

use of the office building and the 87th Ave. property and that it should be permitted to recover TY rent expense of $12,000 for use of approximately 4,000 square feet within an approximately 14,000-square-foot workshop facility. (Ex. A-3 at 21; Ex. A-15; Ex. A-17.) Each of these properties is discussed separately below.

a. Office Building

New River's office building is at 79th Avenue and West Deer Valley Road in Peoria,[42] "right smack dab in the middle of a residential neighborhood," in a 2,200-square-foot house that has been converted to serve as an office. (Tr. at 347, 350; Ex. A-3 at 21.) The office building is on the same parcel as the employee home provided as part of the compensation to New River's field technician and is directly across the street from the Fletchers' home. (Tr. at 71-72, 147.) The office building is used to provide customer service, to conduct billing, and to perform all other business functions of New River, and is open from approximately 7:30 a.m. to approximately 3:30 p.m. for these functions. (Tr. at 77, 167-68.) In a data response provided to Staff, Mr. Fletcher stated that New River "does not have information or documentation regarding the actual cost of the business office property and improvements." (Ex. A-16; *see* Tr. at 77.)

Staff has recommended that New River be permitted to recover annual rent expense of $23,580 for the business office. (Ex. S-1 at 41-44.) Ms. Brown testified that she used the online real estate database Zillow.com to determine an estimated rent for the business office, assuming that Zillow had taken the nature of the property into account in providing its rent estimate, and obtained an estimated monthly rental price of $1,950 for the property at 7939 W. Deer Valley Road. (Ex. S-1 at 43; Tr. at 348-50.) Staff compared this amount to the rent the Commission pays for a downtown office space used by its Pipeline Safety Division and the rent paid by Ray Water Utility Company, which has approximately the same number of employees as New River and an office space near

[42] Although New River stated its address as 7939 W. Deer Valley Rd. in its application, the records of the Commission's Corporations Division, available through the public STARPAS database and of which official notice is taken, provide New River's address as 7839 W. Deer Valley Rd. (*See*, e.g., New River Corporation Annual Report & Certificate of Disclosure filed February 25, 2013 ("New River 2013 Annual Report").) A number of New River's exhibits admitted herein also show the 7839 address. (*See*, e.g., Ex. A-10; Ex. A-20.)

We also note that the New River 2013 Annual Report shows Mr. Fletcher as New River's only officer and shows that New River is owned by the Robert Fletcher and Mary Fletcher Trust. (*See id.*) In earlier reports, the trust is more fully identified as the "Robert L. Fletcher and Mary Karen Fletcher Family Trust dated July 19, 2002." (*See*, e.g., New River Corporation Annual Report & Certificate of Disclosure filed February 27, 2006.)

downtown Tucson, and determined that $1,965 per month was a reasonable rent for New River's business office. (Ex. S-1 at 43; Tr. at 342-43.) Ms. Brown asserted that New River's business office should have less expensive rent than the other two offices used for comparison because New River's office is in a residential neighborhood and not near a downtown. (*See* Tr. at 343-48.) Ms. Brown also asserted that regardless of the zoning for the property, the rent Staff recommends is reasonable as compared to the rents for the other two offices and after taking into account that no other entity has ever rented the building from Cody Farms, the transaction is a related-party transaction, and New River has never evaluated whether the business office is the most cost-effective office space available to New River. (*Id.* at 348-53.) Ms. Brown opined that the only reason the arrangement exists is to "add another layer of income to the owner." (*Id.* at 353.)

New River has asserted that it should be permitted to recover $48,600 annually, to cover rent paid to Cody Farms for New River's use of the 2,200-square-foot office and the 87th Ave. property, including the well on that property. (Ex. A-3 at 21.) New River asserted that Staff's adjustment would allow only $10.72 per square foot per year for the business office, while the commercial property next door to the business office has a lease cost of $17.50 per square foot per year, indicating that the annual rental value for the 2,200-square-foot office space alone would be $38,500. (*Id.*; Ex. A-4 at 11.) At hearing, New River provided an exhibit indicating that Zillow does not provide estimated values for commercial real estate. (Ex. A-26.) After the hearing, New River provided an LFE showing that the office building's parcel is commercially zoned, with a designation that allows for professional offices and other specified uses compatible with nearby residential areas. (LFE at ex. A, atts. 1 & 2.[43])

b. <u>87th Ave. property</u>

The 87th Ave. property contains two 1-million-gallon water storage tanks, a booster station with four booster pumps, chlorination facilities, arsenic treatment facilities, and an inactive well (Well No. 3). (Tr. at 73, 77.) The improvements, including the pump and motor on the well, are all owned by New River. (*Id.* at 73-74.) The parcel of land on which they sit, however, and the inactive

[43] The attachments referenced are the replacement attachments provided by New River in its Notice of Errata filed October 1, 2013.

well itself, belong to Cody Farms. (*Id.* at 73.) According to Mr. Jones, Cody Farms used to own all of the land in the area, and the 87th Ave. property was "carved out," has never been sold, and is still owned by Cody Farms. (*Id.* at 74.) According to a data response provided by Mr. Fletcher, New River "does not have information or documentation regarding the actual cost of the . . . the 87th Avenue booster plant property and well no. 3[, although] all other improvements on the 87th Avenue booster plant property are included in New River's plant-in-service." (Ex. A-16; *see* Tr. at 77.)

New River has asserted that it should be permitted to recover $10,100 annually as rent paid to Cody Farms for New River's use of the 87th Ave. property, including the inactive well on that property. (*See* Ex. A-3 at 21.) New River asserted that allowing no rent expense for the 87th Ave. property would be inappropriate and that the additional amount of $10,100 per year would be a reasonable rental cost for that property. (Ex. A-3 at 21.)

Staff has asserted that no rent should be permitted for the 87th Ave. property because New River's renting the 87th Ave. property from Cody Farms is not in the public interest. (Ex. S-1 at 42.) Staff expressed concern that the 87th Ave. property would not be protected from Cody Farms' creditors in the event of legal and financial problems if the Fletchers declared bankruptcy or died. (*Id.*) Staff asserted that this situation could result in at least the threat of disruption in water service to New River's customers. (*Id.*) Staff recommended that the Fletchers transfer the 87th Ave. property to New River. (*Id.* at 43.)

Mr. Jones discussed with the Fletchers whether they would be willing to transfer ownership of the property from Cody Farms to New River, and Mr. Fletcher indicated that he would be willing to make the transfer if New River were to purchase the property at fair market value, and the cost for the property were included in New River's rate base. (Tr. at 74-75.) New River did not provide an estimated fair market value for the property. (*See id.*)

Ms. Brown testified at hearing that Staff's recommendation was for Cody Farms to transfer the 87th Ave. property to New River at no cost, but that she believed it would be acceptable for the property to be included in rate base at fair value, if it were transferred to New River at no cost, although Staff's Director would have the final decision on Staff's position. (Tr. at 341-42.) Ms. Brown also pointed out that if the owner had transferred the 87th Ave property to New River, the

owner would have only recovered the rate of return on that property instead of recovering, through the lease situation, an increased amount that causes customers to have higher rates. (Tr. at 338-39.)

c. Workshop Facility

The workshop facility is a portion of a 14,000-square-foot building owned by Cody Farms, located approximately three blocks away from the office building, and shared by Cody Farms and New River. (*See* Ex. A-17; Tr. at 147.) New River has asserted that it uses approximately 4,200 square feet of the workshop facility, for which it pays $12,000 per year in rent (originally characterized as "management fees") as well as the electric bill for the entire facility, which totaled $1,423.01 for the TY. (Ex. A-15; Ex. A-17.) Cody Farms pays all other costs for the facility. (Ex. A-15; Ex. A-17.) No specific areas of the workshop are dedicated exclusively to be used for New River. (Tr. at 125-26.) However, New River provided photographs taken by Mr. Jones to show areas of the workshop facility that Mr. Jones asserted are used by New River. (*See* Ex. A-19; Tr. at 83-84.) The photographs showed that the workshop facility consists of a small, segregated air-conditioned area holding a workbench and numerous tools and parts; a much larger non-air-conditioned warehouse-like area holding several golf carts (one of which is owned by New River), a small trailer, a truck (not owned by New River), a small forklift (not owned by New River), several large power tools, and parts and supplies; and a separately partitioned restroom area. (*See* Ex. A-19; Tr. at 83-92.) Mr. Jones testified that New River uses the workshop space to store materials and supplies and to work on vehicles and equipment. (Ex. A-3 at 21.) Mr. Jones testified that Cody Farms only uses the workshop to provide space for the Fletchers' personal use, mainly to store a collection of approximately 15-20 vintage automobiles and tractors owned by the Fletchers. (*See* Tr. at 124-25.)

Staff has recommended reducing the rent amount for the workshop from $12,000 to $3,000, based upon a rent of $3.00 per square foot[44] and a space of 1,000 square feet. (Ex. S-1 at 44.) Ms. Brown testified that when she inspected the workshop facility and asked Mr. Fletcher to show her New River's items, he pointed out only materials and supplies stored in the small segregated room. (*See* Tr. at 332.) Ms. Brown asserted that the materials and supplies he pointed out were along one

[44] Staff used $3.00 per square foot as the rate because it was consistent with the $12,000 annual rate proposed by New River for a space of approximately 4,000 square feet. (*See* Ex. S-2 at 24; Tr. at 331.)

wall of the small room, which she stated was approximately 1,000 square feet in size. (Ex. S-1 at 44.) Ms. Brown testified that the 1,000-square-foot recommendation actually exceeds greatly the space Mr. Fletcher showed her as containing items for New River, which she estimated to be approximately 100 square feet in size. (*See* Tr. at 334-35; Ex. S-2 at 24.)

At hearing, Staff provided its own photographs of the workshop facility, showing very large unused spaces and that the workshop housed a number of large items not owned or used by New River, including approximately nine classic tractors, several classic automobiles, several classic gas pumps, and another classic vehicle. (*See* Ex. S-9; Tr. at 294-98.) The photos also showed that the area housing the restrooms contained a number of decorative items as well as what appeared to be landscaping or gardening supplies; that the facility primarily contained items that did not appear to be water utility supplies; and that the segregated air-conditioned area contained another classic tractor and what appeared to be a covered automobile. (*See id.*) Ms. Brown testified that Staff recommended not that New River's usage at the facility be confined to one specified 1,000-square-foot area, but that New River be permitted to use a total of 1,000 square feet, apportioned in whatever manner New River desired. (Tr. at 296.) When asked about New River's need for additional workshop space to work on vehicles, Ms. Brown stated that New River would have no need to work on vehicles because the vehicles used for service are all leased from Cody Farms. (Tr. at 332-33.) Ms. Brown also asserted that, based on the invoices provided by New River to support equipment repairs and maintenance expenses, outside companies have been performing the repair and maintenance work for New River. (Tr. at 333.)

Ms. Brown pointed out that the workshop rental was not the result of arm's-length bargaining by two parties protecting their own interests. (Tr. at 335.) Ms. Brown opined that New River's materials and supplies probably would have fit in a home storage shed, but that because of the nature of the relationship between New River and Cody Farms, New River had no opportunity to decide to buy its own small storage shed and avoid paying a proposed rent amount that was too high. (*Id.* at 335-36.) Ms. Brown explained that Staff's recommendation was formulated by applying NARUC allocation principles for affiliated transactions, using square footage as the cost driver and the specific area identified by Mr. Fletcher as holding New River's items, and then allowing an additional space

allowance to come up with 1,000 square feet and a rate based thereon. (*See* Tr. at 336-38.)

d. Resolution

New River has been engaging in affiliated transactions with Cody Farms, originally presented as management service arrangements and now presented as unwritten lease arrangements,[45] to the enrichment of Cody Farms and the Fletchers. If permitted by the Commission, the affiliated transactions with Cody Farms now presented as unwritten lease arrangements would result in annual expenses of $60,600, all to be covered by New River's ratepayers. Staff would allow $23,580 of that amount for New River to rent the office building and $3,000 of that amount for New River to rent an unspecified 1,000-square-foot portion of the workshop facility. Staff would also require that the 87th Ave. property be transferred to New River, at no charge, to ensure that New River is protected from loss of access to the property in the event of the death or bankruptcy of the Fletchers (or Cody Farms) and the disruption in water service to New River's customers that could ensue.

"The Commission disfavors non-arm's length transactions and has broad authority to scrutinize such transactions and to disallow expenses related to them that are not fully justified." (Decision No. 71445 (December 23, 2009) at 41-42 (citing *U.S. West Communications, Inc. v. Arizona Corp. Comm'n*, 185 Ariz. 277, 282 (Ariz. Ct. App. 1996)).[46]) In this case, New River has not established, for any of the three disputed properties, that New River based the non-arm's length rental arrangements upon fair market rental costs for comparable properties. Indeed, New River originally did not characterize these transactions as rental arrangements at all, instead characterizing them as "management services" provided by Cody Farms, although New River has acknowledged that Cody Farms' only local business operations are collection of rental payments.[47] New River has not established that it made any effort to find or consider less expensive alternative properties or arrangements, that it explored the rental prices for comparable properties before determining that the rental arrangements with Cody Farms were at fair market rates, or that it even knows either the fair market value or the original cost for the properties held by Cody Farms and "rented" by New River (a claim that is not credible in light of the Fletchers' experience with land development). As New River

[45] *See, e.g.*, Jones Dir. at Sched. C-1, Sched. E-2; Ex. A-10; Tr. at 126-27, 151.
[46] Official notice is taken of Decision No. 71445 (December 23, 2009).
[47] As noted above, the annual amount of management fees in each of the two years prior to the TY was $500,000.

has failed to establish through its evidence that the rental expenses claimed by it are fair and in the public interest, and will result in just and reasonable rates, the Commission will not allow recovery of those expenses. Rather, the Commission will allow recovery of the Staff-recommended annual rental expense of $3,000 for New River's use of a portion of the workshop and of the Staff-recommended annual rental expense of $23,580 for New River's use of the residential building converted into a business office.[48] This level of expense reflects a reasonable cost for a utility of New River's size.

Additionally, like Staff, the Commission is concerned about New River's continued ability to access, and use for its operations, New River's facilities that are located on the 87th Ave. property still owned by Cody Farms. In the best case scenario, such a situation could present complications and possibly obstacles to access if the Fletchers were to sell either New River or Cody Farms to an unaffiliated entity. As Staff noted, such a situation could even result in a loss of access to and use of the facilities located on the property in the event of bankruptcy or death. The Fletchers, as the individuals in control of the disposition of the 87th Ave. property through Cody Farms, chose to install New Rivers' facilities on that property without transferring the property's ownership from Cody Farms to New River. New River has not established any reason for the property not to be transferred to New River, other than the reason asserted by Ms. Brown for Staff—the property has been providing Cody Farms (and thus the Fletchers) with another source of income from New River's operations, in the form of "management fees" now recharacterized as rents. The Commission finds this situation not to be in the public interest. Rather, the Commission finds, under A.R.S. § 40-203, that the Fletchers' decision to require New River to pay Cody Farms for use of the land on which their common owners (the Fletchers) chose to install New River's facilities (whether the charges are characterized as "management fees" or rent) is an unjust, preferential, and insufficient practice. Accordingly, the Commission finds that this unjust, preferential, and insufficient practice must end through one of several options. New River could end this practice by having the Fletchers transfer ownership of the land from Cody Farms to New River.[49] Alternatively, the Fletchers could craft,

---

[48] The Commission considered complete disallowance of the rental expenses and considered whether it would be appropriate to pierce the corporate veil.

[49] The Commission has previously ordered the transfer of affiliate-owned property to a public service corporation when the Commission determined it necessary for the public service corporation to provide adequate service to its ratepayers.

execute, and record an instrument providing New River an enforceable right to permanently access and use its facilities installed on the 87th Ave. property, which right would run with the land. A third option would be for New River to find and purchase another property upon which its facilities could be installed, as the well on the 87th Ave. property is not used. If the 87th Ave. property is transferred to New River, New River may request in its next rate case to have the fair value of the transferred property included in its rate base. If New River instead has been granted an enforceable right to permanent access and use of its facilities installed on the 87th Ave. property, New River may request in its next rate case to recover the fair value of such right of access and use either as an amortizing asset to be included in rate base or as an operating expense, whichever is determined by the Commission to be appropriate under the NARUC USOA and Commission rules based upon how the transaction granting such right of access has been structured. If New River instead acquires another property through an arm's length transaction, New River may request in its next rate case to have the fair value of that property included in its rate base. Regardless of which option is chosen, New River will be required in its next rate case to provide objective evidence establishing the fair value of the property or right transferred or obtained.

4. Rent, Vehicles

New River has proposed $24,000 in TY expenses for equipment rental to cover vehicle rental costs for a 2006 Chevrolet Silverado 1500 truck used by Mr. Fletcher, a 2005 Chevrolet Silverado 1500 truck used by Mrs. Fletcher, a 2005 Chevrolet Silverado 2500 truck used by the field technician, a 2003 Ford F-250 truck used by the customer service representative, 1997 and 1999 flatbed trailers used by the field technician, and a 1989 forklift used by the field technician. (Jones Dir. at Sched. C-1; Ex. S-1 at 44-45, Sched. CSB-33.) The vehicles are all owned by Cody Farms, and New River has asserted that it pays Cody Farms a combined rent of $1,600 per month for the four trucks and the two trailers and a rental fee of $400 per month for the forklift, for a monthly total of $2,000 and an annual total of $24,000. (Ex. A-13.) New River also has asserted that it began paying rent to Cody Farms for the use of these vehicles in 2009 and that only the forklift is also used by an affiliate, with Cody

---

(*See* Transcript of April 27, 2011, Open Meeting/Hearing filed in Docket No. W-02391A-10-0218 et al. on May 16, 2011, at pages 73-79. Official notice is taken of this Transcript.)

Farms using it "occasionally . . . to unload a delivered item."[50] (*Id.*) New River has also asserted that none of the trucks is used primarily to read meters,[51] although the trucks assigned to Mrs. Fletcher and to the customer service representative may be used for meter re-reads and to deliver bills to the post office. (Ex. A-14.) Mr. Jones testified that from his observations, the field technician's truck is never at the office, and the trucks assigned to Mr. and Mrs. Fletcher and the customer service representative are generally at the office when Mr. Jones is there. (Tr. at 148-49.)

New River has not been keeping any usage logs for the vehicles. (Ex. A-13.) Mr. Jones did not know to what extent the vehicles are used for personal use, but stated that the Fletchers have another truck and an SUV that they own personally and use to travel to their property in Cornville. (Tr. at 149.) Mr. Jones opined that it is appropriate for New River to have four vehicles because smaller utilities like New River have a greater need for vehicle redundancy than do larger utilities. (Tr. at 172, 176-78.) New River has not performed any studies to determine whether renting vehicles from Cody Farms is more cost-effective than purchasing vehicles, and Mr. Fletcher based the rental charges on an "informal fair market analysis [without] a provision for overhead or profit." (Ex. A-13.) New River also asserted that it does not have documentation of the costs of the vehicles. (*Id.*) Instead, New River provided estimated costs for the vehicles based upon Mr. Fletcher's recollection of what he paid for them, along with the years in which New River began using each vehicle and the estimated hours of usage each month for the forklift and the two trailers.[52] (*Id.*) New River indicated that except for the truck used by the customer service representative and the forklift, New River began using the vehicles in their model years. (*Id.*)

Staff has recommended adjusted TY vehicle rental expense of $8,836. (Ex. S-1 at 44-45, Sched. CSB-22, Sched. CSB-33.) To calculate the recommended expense for each vehicle, Staff divided the monthly rental expense provided by New River by 22 work days per month to obtain a daily rate, multiplied the daily rate by an estimated number of work days used per month to obtain a monthly cost, and then annualized the cost. (Ex. S-1 at Sched. CSB-33; Ex. S-3 at Rev. Surr. Sched.

---

[50] Cody Farms' usage was estimated at less than one hour per month. (Ex. A-13.)

[51] New River primarily uses golf carts to read meters, although some meter reading is done with a truck, and follow-up and re-read meter reading is done with a truck. (Tr. at 128.)

[52] New River indicated that the forklift is used 4 to 8 hours per month, that the 1997 trailer is used 16 to 24 hours per month, and that the 1999 trailer is used 0 to 8 hours per month. (Ex. A-13.)

CSB-33.) Staff estimated full-time use for the field technician's truck, half-time use for Mr. Fletcher's and the customer service representative's trucks, no use for Mrs. Fletcher's truck, and minimal use for the trailers and forklift. (Ex. S-3 at Rev. Surr. Sched. CSB-33.) As a result, Staff recommended $4,800 for the field technician's truck, no allowance for Mrs. Fletcher's truck, $2,400 for Mr. Fletcher's truck, $1,200 for the customer service representative's truck, and $436 combined for the two trailers and the forklift. (*Id.*) Staff's recommended allowance of $8,836 represents a reduction of $15,164 from New River's proposed $24,000 expense.[53] (*See id.*; Ex. A-4 at Sched. C-1.)

New River has disagreed with Staff's recommended disallowance of rental costs for one of the trucks. (Tr. at 30-31.) Mr. Jones asserted that Staff's adjustment to the rental expenses assumed an "alternate reality" in which a vehicle can be rented at a monthly rate but paid for on a per-day basis, something New River describes as impossible. (Ex. A-3 at 22.) Mr. Jones also asserted that all utilities must have vehicles available to them at all times, although those vehicles may not be used daily, and must pay for that daily availability. (*Id.*; Tr. at 31.) Mr. Jones likened Staff's adjustments for the forklift and trailers to renting a car, having possession of the car for a full month, using the car only four or five days out of the month, and then expecting to pay rental charges only for the days the vehicle was actually used. (Tr. at 32.) New River maintained that the entire $24,000 should be allowed as a TY expense. (Ex. A-4 at 11-12.)

At hearing, Ms. Brown testified that Staff had scrutinized these vehicle rental transactions more closely because they are all related-party transactions and not the outcome of "bargaining [by] two entities that are looking out for their own best interest[s]." (Tr. at 298-99.) Ms. Brown asserted that Mr. Fletcher could have chosen to assign ownership of the vehicles to New River, but did not; that three of the four trucks would have been fully depreciated already if Mr. Fletcher had assigned ownership to New River; and that ratepayers would have benefited from assignment of ownership to New River because ratepayers would no longer be paying for depreciation on the fully depreciated vehicles. (*Id.* at 299.) Staff determined that allocating all of the annual costs of the trucks to New

[53] Staff misstated this as a recommended reduction of $13,164 from a proposed $22,000 expense item. (*See*, e.g., Ex. S-3 at Rev. Surr. Sched. CSB-33.)

River was not reasonable and was not in accordance with the NARUC USOA, particularly because New River could not produce any mileage logs or provide actual miles or number of days and hours used.[54] (*Id.* at 299-300.) Ms. Brown asserted that Staff had used its professional judgment to estimate costs that it believed could be appropriately allocated to New River and Cody Farms, based on Staff's determination that the office staff could perform with only the vehicles of Mr. Fletcher and the customer service representative. (*Id.* at 300-03.)

As stated previously, the Commission disfavors non-arm's length transactions by public service corporations, due to the dangers of self-dealing inherent in such transactions, the consequences of which fall squarely on the shoulders of ratepayers. Thus, the Commission subjects such transactions to more intense scrutiny than it does other transactions. The arrangement for New River to "rent" a full-size or larger pick-up truck from Cody Farms for each full-time employee of New River, along with a forklift and two trailers that are used only sporadically, all at costs that may be excessive in light of the vehicles' ages, is unreasonable and not in the public interest. New River cannot establish the need for the vehicles through usage data, as it does not maintain any usage logs for the vehicles. We note that New River's entire service area is only 1.75 square miles in size, which means that even traversing the entire service area would not tie up a vehicle for a significant length of time. Also, we note that New River's meter-reading activities are primarily conducted using its own golf carts, not any of the rented vehicles. New River also claimed to have no documentation establishing the cost of any of the vehicles, although New River also indicated that all but two of the vehicles had been placed into service during their model years (strongly suggesting that the vehicles were newly acquired when put into service). New River's claims not to have any records of the vehicle costs or of their usage are implausible,[55] and New River should not be

---

[54] Ms. Brown pointed out that the Internal Revenue Service requires travel logs for mileage expense to be claimed. (*Id.* at 302.) Both Mr. and Mrs. Fletcher became agitated during this portion of Ms. Brown's testimony and were admonished to lower their voices or step outside. (*See* Tr. at 302-03.) In spite of their apparent objections to Ms. Brown's testimony, neither Mr. nor Mrs. Fletcher appeared as a witness for New River.

[55] If for no other reason, New River should have this information because it would be needed for tax purposes. As Ms. Brown testified, the Internal Revenue Service ("I.R.S.") requires vehicle usage records to be maintained in order for vehicle expenses to be claimed. (*See* I.R.S. Pub. 463 (Feb. 20, 2013), of which official notice is taken.) Additionally, Arizona law requires the sales price of a vehicle to be provided for the calculation of use tax. Official notice is taken of A.R.S. § 28-2056, which requires use tax to be collected upon application to transfer the title of or register a vehicle and requires a receipt to be issued for the tax paid. Official notice is also taken of A.R.S. § 42-5155, which requires use tax to be levied based upon the sales price of a vehicle.

rewarded for this claim by having the Commission accept New River's proposed costs/values for the vehicles, which would impact the vehicles' market rental costs. New River has provided no documentation and no market-based support to establish that the rental cost claimed for any of these individual vehicles is reasonable. Under the circumstances, Staff's recommended TY vehicle rent expense of $8,836 is a reasonable approximation of an appropriate vehicle rental expense for a utility such as New River and will be adopted.

5. Transportation

In its application, New River proposed TY transportation expenses of $26,580. (Jones Dir. at Sched. C-1; Ex. S-1 at Sched. CSB-34.) New River subsequently agreed to two Staff adjustments reducing this amount by removing $4,020 as costs related to an affiliate and $6,512 in engine rebuild costs that were instead capitalized. (Ex. A-4 at Sched. C-2 Rej.) New River has disputed Staff's recommended disallowance of an additional $2,797, representing the transportation costs for one of New River's four trucks, and has proposed TY transportation expenses of $16,048. (Ex. A-4 at 11-12, Sched. C-1 Rej; Ex. A-3 at 20.)

Staff separated New River's initially proposed TY transportation expenses into $17,314 in gas and oil costs and $9,265 in repair and maintenance expense. (Ex. S-1 at Sched. CSB-34.) Staff's disputed adjustment was then calculated by deducting from the proposed gas and oil costs two "abnormally large" transportation purchases made with a credit card ($2,106 and $4,021)[56] and then dividing the remaining $11,188 by four to obtain $2,797 in gas and oil costs for each truck. (Ex. S-1 at 45, Sched. CSB-34.) Staff has recommended disallowance of $2,797 as the gas and oil costs for Mrs. Fletcher's truck, for which Staff recommended disallowance of vehicle rental expense. (*See id.*; Tr. at 303-04.)

As New River has acknowledged, the disputed $2,797 adjustment in transportation expenses is a companion adjustment to the exclusion of vehicle rental expense for one of New River's trucks. Because we have determined that exclusion of the vehicle rental expense for one truck is just and reasonable, we likewise conclude that the companion adjustment, to exclude a reasonable amount

[56] Although Ms. Brown's direct testimony referred to normalization of these costs over three years, it did not appear that a portion of these costs was included in Staff's recommended TY transportation expense. (*See* Ex. S-1 at 45, Sched. CSB-34; Ex. S-3 at Rev. Surr. Sched. CSB-34.)

representing oil and gas expenses for one truck, is just and reasonable and in the public interest.

6. Bad Debt

In its application, New River reported actual TY bad debt expense of $7,688 and proposed recovery of that amount. (Jones Dir. at Sched. C-1.) Mr. Jones testified that although New River had not tracked and did not know the amounts of its bad debt expense in the two years prior to the TY, because it instead had recorded revenues net of bad debt expense, New River had tracked and recorded bad debt expense for the TY. (Tr. at 32-33, 129.) Thus, Mr. Jones asserted, New River should be able to recover its actual bad debt expense rather than a reduced amount, because there is no likelihood that New River had zero bad debt expense in those two prior years. (Tr. at 32-33.) Mr. Jones acknowledged that New River should have been tracking its bad debt expense every year and also that it should be possible for a record of bad debts to be reconstructed from the billing system and the documents maintained therein, but stated that the effort had not been undertaken. (Tr. at 152-53.) Mr. Jones also stated that he had worked with both New River and its outside accountant to ensure that New River's accounting practice was changed so that bad debt would be tracked for the TY and going forward. (Tr. at 129, 153.)

Staff normalized New River's bad debt expense over a period of three years because Staff believed that New River's bad debt expense varied widely over those years. (Ex. S-1 at 46.) Staff's normalization calculation included two years with no recorded bad debt expense. (*Id.* at Sched. CSB-35.) Staff thus proposed to decrease bad debt expense by $5,125, allowing recovery of $2,563. (*Id.* at Sched. CSB-21, CSB-22, CSB-35.) At hearing, Ms. Brown testified that while Staff believed it reasonable to allow bad debt expense, Staff did not believe that the amount proposed by New River was reasonable. (Tr. at 304-05.) Ms. Brown acknowledged that there was only a very low likelihood that New River had actually experienced no bad debt in the two years prior to the TY. (Tr. at 359.)

At hearing, New River was directed to provide, as an LFE, the bad debt expense recorded for 2012. (*See* Tr. at 376.) In his affidavit provided with the LFE, Mr. Jones certified that he had examined New River's books and records after the hearing and that New River's bad debt expense for 2012 was $12,699.60. (LFE at 3.)

. . .

The evidence indicates that while New River did not track and record its bad debt expense for the two years prior to the TY, there is a very low probability that New River did not experience any bad debt expense during those years. The evidence also establishes that New River experienced bad debt expense of $7,688 during the TY and that New River experienced greater bad debt expense for the year following the TY. In light of these factors, it is just and reasonable to allow New River to recover its actual TY bad debt expense of $7,688.[57]

7. Depreciation

New River and Staff disagree on an appropriate depreciation expense adjustment as a result of their other disagreements concerning disallowed plant and depreciation methodology. (Tr. at 34.) Mr. Jones explained that the difference attributable to depreciation methodology is $3,635. (*Id.*) Mr. Jones also testified that the difference related to disallowed plant is not a disagreement on the calculation to be used to determine the amount, it is just a "fallout difference" based upon the disagreement as to disallowance of insufficiently supported plant. (*Id.*) New River's rejoinder schedules showed actual TY depreciation expense of $257,284, a pro forma adjustment of ($149,702), and an adjusted TY depreciation expense of $107,582. (Ex. A-4 at Sched. C-1 Rej.) This depreciation amount was calculated using an adjusted depreciable plant balance of $5,559,641 and an 8.00-percent depreciation rate for the pumping equipment account. (*Id.* at Sched. C-2 Rej.)

Staff's revised surrebuttal schedules showed New River-proposed TY depreciation of $245,585, a Staff adjustment of ($148,150), and a recommended adjusted TY depreciation expense of $97,435. (Ex. S-3 at Rev. Surr. Sched. CSB-21.) This depreciation amount was calculated using an adjusted depreciable plant balance of $5,147,681 and a 12.50-percent depreciation rate for the pumping equipment account. (*Id.* at Sched. CSB-37.)

Because we are adopting Staff's position as to both inadequately supported plant and depreciation methodology, we find that New River's depreciation expense must be adjusted accordingly.

. . .

[57] We note that this amount does not exceed greatly the amount that would be achieved with three-year normalization calculated using $0 for 2010, $7,688 for the TY, and $12,699.60 for 2012.

8. Income Tax

New River and Staff have agreed as to the methodology for calculating income tax expense. New River's position on other issues has resulted in proposed TY income tax expense of $33,812. (Ex. A-4 at Sched. C-1 Rej., Sched. C-2 Rej.) Staff's position on other issues has resulted in Staff-recommended TY income tax expense of $84,706. (Ex. S-3 at Rev. Surr. Sched. CSB-2, Rev. Surr. Sched. CSB-38.)

At hearing, Mr. Jones testified that the difference between the parties' positions is "just the fallout from the other disagreements" between the parties, because the parties agree as to the calculation methodology. (Tr. at 33.) New River and Staff also indicated that they were in agreement as to methodology in the joint matrix prepared and submitted by the parties. (Ex. A-6.)

We will adopt a TY income tax figure consistent with our decisions on other disputed issues herein and calculated using the methodology agreed upon by the parties.

9. Taxes Other Than Income

As discussed above, New River has proposed to add an accounting analyst position, with an annual salary of $45,000. As a companion adjustment to that increase in payroll costs, New River has proposed that taxes other than income be increased by $3,600 for the payroll taxes that would result from that new position. (Ex. A-4 at Sched. C-2 Rej.) The proposed adjustment is a flow-through adjustment only. (*See* Tr. at 28-29.)

Staff has opposed the adjustment, consistent with Staff's opposition to the proposed increase in salary expenses to cover a new accounting analyst position, as discussed above.

Because we are adopting Staff's recommendation to disallow $45,000 in increased salary expenses to cover the costs of a new accounting analyst, we likewise will not adopt this flow-through increase to taxes other than income.

. . .

. . .

. . .

. . .

. . .

C. Operating Income Summary

As a result of the resolution of disputed expense items described above, we will adopt the following TY results for New River:

Adjusted Test Year Revenues	$1,260,428
Adjusted Test Year Operating Expenses	$1,051,653
Adjusted Test Year Operating Income	$208,775

VI. COST OF CAPITAL

A. Capital Structure

Because New River and Staff have agreed that New River's rates should be set using its actual capital structure of 100-percent equity, we find using New River's actual capital structure reasonable and will adopt it. We note, however, that New River should consider adding low-cost debt to its capital structure when it next determines that capital improvements are needed.[58]

B. Cost of Equity & Fair Value Rate of Return

Because New River is not a publicly traded company, its cost of equity ("COE") must be estimated. New River has proposed that its COE be determined by examining the COEs approved for other regulated utilities in recent Commission decisions. New River has not calculated COE estimates using established financial models, instead asserting that New River lacked the sophistication and resources to do so. (*See* Ex. A-3 at 29.) Staff has calculated estimates of New River's COE using both the discounted cash flow ("DCF") model and the capital asset pricing model ("CAPM"). The parties' positions on COE and fair value rate of return ("FVROR") are as follows:[59]

	Capital Structure	COE	Fair Value Adjustment	FVROR
New River	100% Equity	10.00%	-1.28%	8.72%
Staff	100% Equity	8.90%	-1.10%	7.80%

1. New River

New River's proposed COE is based upon Mr. Jones's review of rate decisions issued by the Commission in 2012 for Class A, B, and C utilities. (Jones Dir. at 15.) Specifically, in his direct

[58] Any long-term debt would need prior Commission approval.
[59] Ex. A-6.

testimony, Mr. Jones listed the Commission-adopted COEs in decisions issued for Bermuda Water, Goodman Water, East Slope Water, Arizona Water, and Arizona-American Water, utilities with debt levels ranging from 0 percent to 58.73 percent, along with a Staff-recommended COE not adopted by the Commission in a second Arizona-American Water case.[60] (*Id.* at 15-16.) The average of the equity returns listed was 9.945 percent. (*See id.* at 16.)

New River's proposed fair value inflation adjustment was determined by Mr. Jones using a methodology approved by the Commission in Decision No. 71308 (October 21, 2009).[61] (*Id.* at 16.) The procedure involved subtracting the 20-year Treasury real yield from the 20-year Treasury yield (both as of October 22, 2012) and then reducing the result by 50 percent. (*Id.* at 16, Sched. D-1.))

On rebuttal, New River provided a different list of Commission-approved returns on equity ("ROEs"), including ROEs granted in decisions issued between January 2012 and February 2013 for Southwest Gas Corporation, Bermuda Water Co., Chino Meadows II Water Co., Indiada Water Co., Arizona Water Co.'s Western Group, Arizona-American Water Co., UNS Electric, Arizona Public Service Co., Pima Utility Co., and Arizona Water Co.'s Eastern Group. (Ex. A-3 at 29.) Based on the average ROE for this group of 9.85 percent, New River continued to propose a 10.00-percent COE and a 1.280-percent fair value inflation adjustment,[62] for a FVROR of 8.720 percent. (*Id.*)

New River took issue with Staff's lower recommended COE, asserting that it was far below the COE granted by the Commission in recent decisions and also inconsistent with Staff's recommendation made in another case shortly after Staff's direct testimony was filed, which Mr. Jones stated had relied on older data than used in this case. (*Id.* at 28.) Mr. Jones asserted that this indicates "Staff is over reliant on models that are subject to unreasonable and sudden shifts in the model output over relatively short periods of time as inputs change." (*Id.* at 29.) Mr. Jones characterized the models as "unreliable and unpredictable tools for determining the cost of equity."

---

[60] The Commission decisions involved were issued in the following truncated Dockets Nos., respectively: 10-0521, 10-0521, 10-0168, 10-0517, 10-0488, and 09-0343. (*See* Jones Dir. at 16.)

[61] Official notice is taken of Decision No. 71308, involving Chaparral City Water Company, Inc., in which the Commission adopted a method of calculating the inflation factor in the weighted average cost of capital ("WACC") and subtracted the inflation factor from WACC so as not to allow the overcompensation for inflation that would result from applying the WACC directly to a FVRB determined using both OCRB and RCNRB.

[62] At hearing, Mr. Jones testified that the small difference in the fair value inflation adjustment is attributable to timing difference. (Tr. at 35.)

(*Id.*) Mr. Jones also expressed concern that "Staff could manipulate inputs in order to get a predetermined result." (*Id.*) Mr. Jones asserted that he believes reliance on recent decisions is "the most viable way to determine cost of capital for small utilities that do not have the resources to produce their own competing equity model." (*Id.* at 30.)

New River's proposed COE and FVROR did not change on rejoinder, although New River added a recently proposed Global Water settlement agreement as additional support for its position. (Ex. A-4 at 17-18.) Mr. Jones also took issue with Staff's criticism of New River's not having included a downward financial risk adjustment in determining its proposed COE, arguing that Staff previously had stated on direct that a downward financial risk adjustment is only appropriate when a utility has access to equity capital markets, which New River does not. (*Id.* at 18-19.)

At hearing, Mr. Jones explained that he selected the companies included in his testimony based on having been able to find Commission decisions with identifiable ROEs and the goal of being as broad as possible in finding examples. (Tr. at 141.) Mr. Jones acknowledged both that his list of decisions did not include every company that had an ROE approved by the Commission in the time periods and that some of the utilities used in his comparison are electric utilities, which he believes are less risky enterprises than are small water utilities. (Tr. at 141.) Mr. Jones asserted that he also compared recent Commission-approved COEs with COEs recently approved in California. (Tr. at 139.)

2. Staff

Staff's recommended COE was determined by averaging the results of Mr. Cassidy's DCF model and CAPM analyses and then adding a 60-basis point upward economic assessment adjustment. (Ex. S-4 at 3.) Mr. Cassidy performed his analyses using a sample group of six publicly traded water companies that receive most of their earnings from regulated operations, including American States Water, California Water, Connecticut Water Services, Middlesex Water, Aqua America, and SJW Corp. (*Id.* at 13.) These sample companies had capital structures of approximately 51.2 percent debt and 48.8 percent equity. (*Id.* at 12.) Mr. Cassidy testified that the sample utilities have financial risk that New River does not, because financial risk increases with the level of a company's debt, and New River has no debt. (*Id.* at 11.) Mr. Cassidy also testified that

firm-specific risk does not affect COE because firm-specific risk can be eliminated by investors through diversification. (*Id.*)

The DCF model uses expected dividends, market price, and dividend growth rate to calculate cost of capital, based on the premise that the value of an investment is equal to the sum of the future cash flows generated from the investment, discounted to the present time. (*Id.* at 13-14.) Mr. Cassidy used two versions of the DCF model in his analyses: the constant-growth DCF model, which assumes that an entity's dividends will grow indefinitely at the same rate, and the multi-stage growth DCF model, which assumes that the dividend growth rate will change at some point in the future. (*Id.* at 14.) To calculate the expected yield component of the constant-growth DCF model, Mr. Cassidy used the spot stock price after close of market on May 29, 2013, because a current spot price is considered to capture all available information. (*Id.* at 15.) Mr. Cassidy calculated the dividend growth component by averaging the outcomes of six different estimation methods, using both historical and projected growth estimates on dividend-per-share ("DPS"), earnings-per-share ("EPS"), and sustainable growth bases, with the end result being an average dividend growth rate of 4.8 percent. (*Id.* at 16-23, Sched. JAC-8.) Mr. Cassidy's analysis resulted in a constant-growth DCF estimate of 7.8 percent. (*Id.* at 23.) For the multi-stage growth DCF model, Mr. Cassidy calculated the stage-1 growth rate using *Value Line*'s projected dividends for the next 12 months, when available, and the calculated dividend growth rate of 4.8 percent when not available. (*Id.* at 25.) Mr. Cassidy then calculated the stage-2 growth rate using the arithmetic mean growth rate for Gross Domestic Product ("GDP") from 1929 to 2011, which assumes that the water utility industry grows at the same rate as the overall economy. (*Id.*) Mr. Cassidy's analysis resulted in a multi-stage DCF estimate of 9.4 percent. (*Id.*) Mr. Cassidy then averaged the two DCF estimates to reach Staff's overall DCF estimate of 8.6 percent. (*Id.*)

The CAPM is used to estimate COE based on the premise that an investor requires the expected return on a security to equal the rate on a risk-free security plus a risk premium, and it assumes that every investor has sufficiently diversified investments to eliminate any non-systematic or unique risk. (*Id.* at 26.) The CAPM uses a risk-free interest rate, a market risk premium, and a

beta (which represents systematic risk—the riskiness of an investment relative to the market).[63] (*Id.* at 27.) Mr. Cassidy performed CAPM analyses using both a historical market risk premium (the average of three intermediate-term U.S. Treasury security spot rates) and a current market risk premium (the 30-year U.S. Treasury bond spot rate). (*Id.*) For beta, Mr. Cassidy used the average beta for the sample group of 0.71. (*Id.*) The results of Mr. Cassidy's analyses were a historical market risk premium of 7.1 percent, a current market risk premium of 7.61 percent, a historical market risk premium CAPM of 6.6 percent, and a current market risk premium CAPM of 8.7 percent. (*Id.* at 28-29.) Mr. Cassidy then averaged the historical and current CAPM results to reach an overall CAPM COE estimate of 7.7 percent. (*Id.* at 30.)

Staff's initial COE estimate was reached by averaging Staff's overall DCF estimate of 8.6 percent with Staff's overall CAPM estimate of 7.7 percent, with the result being 8.2 percent. (*Id.* at 32.) In spite of New River's 100-percent-equity capital structure, Staff did not recommend a downward financial risk adjustment for New River because New River does not have access to equity capital markets. (*Id.* at 33.) Staff did recommend approval of an upward economic assessment adjustment of 60 basis points, resulting in a COE and WACC of 8.8 percent. (*Id.* at 34.) Staff then calculated an inflation adjustment/accretion return, to be used as a deduction from WACC to account for inflation reflected in the RCNRB portion of the FVRB. (*Id.* at 35-36.) Staff used the same methodology used by New River to calculate the inflation adjustment, but used the yield on 30-year U.S. Treasury bonds instead of the yield on 20-year U.S. Treasury bonds to calculate the portion of the return required by an investor due to inflation. (*Id.*) Mr. Cassidy stated that the 30-year bond more closely reflects the weighted average life of the plant included in FVRB than does a 20-year bond and also that 20 years was the longest term available when the methodology was approved by the Commission. (*Id.* at 36.) As a result of Mr. Cassidy's analysis, Staff recommended a 1.2-percent inflation adjustment/accretion return deduction from WACC to reach Staff's recommended FVROR of 7.6 percent. (*Id.* at 37-38.)

. . .

[63] A beta higher than 1.0 is considered to be more risky than the market, and a beta lower than 1.0 is considered to be less risky than the market. (Ex. S-4 at 28.)

Staff did not address Mr. Jones's COE direct testimony other than to state that Mr. Jones had not performed any market-based analysis of COE and instead had relied upon a review of decisions in other cases. (*Id.* at 37.) Staff indicated that this was inappropriate because COE varies with time, is dependent on capital structure, and should be adjusted to reflect differences among sample companies. (*Id.* at 37.)

On surrebuttal, Mr. Cassidy updated Staff's recommendation based on additional analyses using more recent market data. (Ex. S-5 at 2.) Staff's updated COE was 8.3 percent, based on an average DCF method result of 8.6 percent and an average CAPM result of 7.9 percent. (*Id.*) After applying the 60-basis-point upward economic assessment adjustment, Staff reached an 8.9 percent WACC. (*Id.* at 3.) Staff also applied an updated inflation adjustment/accretion return of 1.1 percent to reach Staff's final recommended FVROR of 7.8 percent. (*Id.*)

In response to Mr. Jones's rebuttal testimony, Mr. Cassidy pointed out that Mr. Jones again had not based his proposed FVROR on any market-based analysis. (*Id.* at 4.) Mr. Cassidy asserted that this is inappropriate because COE represents investors' expected returns, which can only be determined in the marketplace. (*Id.* at 4.) Mr. Cassidy further asserted that prior authorized ROEs should not be relied upon to determine COE because ROEs and COEs are not equivalent. (*Id.* at 5.) Mr. Cassidy also pointed out the disparity in capital structures between New River and the utilities referenced by Mr. Jones, several minor errors included in Mr. Jones's testimony, and that the 10 cases included in Mr. Jones's rebuttal testimony included four cases in which the ROEs had been determined through settlement rather than litigation.[64] (Tr. at 252-53.) Mr. Cassidy also asserted that it would be inappropriate for Staff to expand on its position in the pending Global Water case referenced by Mr. Jones, other than to state that the COE analysis in the Global Water case had actually been completed before Staff's analysis in this case. (*Id.* at 6-7.)

At hearing, Mr. Cassidy reiterated that the primary shortcoming of Mr. Jones's testimony was that it did not include any formal market-based COE analysis. (Tr. at 210, 248-49.) Mr. Cassidy asserted that New River's proposed 10-percent COE has no market-based support. (*Id.*) Mr. Cassidy

[64] Mr. Cassidy identified the cases involving Southwest Gas Corp., Arizona-American Water Co., UNS Gas Corp., and Arizona Public Service Co. as having been resolved through settlement. (Tr. at 253.)

also explained that Staff has been making the 60-basis-point economic assessment adjustment recently in recognition of national and international "uncertainty" that may not be fully captured in the results of the market-based analysis. (Tr. at 213-22.) Mr. Cassidy stated that the economic assessment adjustment also takes into account regulatory lag, although he conceded that he had not specifically mentioned that in his prior written testimony and that he personally had not engaged in a quantitative analysis to determine the 60-basis-point economic assessment adjustment. (*Id.* at 215-22, 228-30.) Mr. Cassidy emphasized that Mr. Jones's proposed 10-percent COE, which is higher than the average ROE for the 10 cases included in Mr. Jones's list of decisions, would compensate New River for financial risk that it does not experience because of its capital structure. (*Id.* at 253-54.)

3. Discussion and Resolution

Staff has performed extensive market-based analyses to determine Staff's recommended COE. When COE is disputed, the Commission traditionally relies upon market-based analyses as the most reliable source to estimate accurately what the market expects and requires. New River has not performed any market-based analysis to rebut Staff's results and instead has proposed that the Commission determine New River's COE by averaging the ROEs authorized in 10 other cases, involving a mix of other utilities, over a period between January 6, 2012, and February 20, 2013. The majority of the utilities included in New River's list have capital structures very different from the 100-percent-equity capital structure of New River. A number of the utilities also are in different sectors of the utility industry than New River, a factor that may affect the appropriateness of a comparison. Additionally, four of the cases referenced involved settlement agreements with ROEs upon which the parties to those cases had agreed, and another involved an agreed ROE without a settlement agreement. The resolution of an issue in the context of a settlement also calls into question the appropriateness of any comparison.

Assuming *arguendo* that New River's method of estimating COE by reviewing recent ROEs for other utilities were valid, we note that the average ROE for the listed water utility cases that have

fully concluded[65] and that did not involve settlement agreements[66] is 9.4775 percent. (*See* Ex. S-5 at Surr. Ex. JAC-A.) This is considerably lower than New River's proposed COE of 10.0 percent, based on an average ROE it calculated at 9.85 percent. Additionally, we note that New River has acknowledged that the listed cases do not represent all of the rate case decisions issued by the Commission during the time period shown. No evidence was presented of what the average ROE would be if all of the rate case decisions issued during that time period were considered.

After considering all of the evidence presented herein on the issue of COE and FVROR, we conclude that Staff's recommended COE of 8.90 percent, which is based on a thorough market-based analysis and which includes an additional 60-basis point upward economic assessment adjustment to address uncertainty in the world economic environment as well as regulatory lag, will provide New River with a reasonable and appropriate return on its investment and will result in just and reasonable rates. We have factored into this determination the fact that New River has chosen to maintain a capital structure of 100-percent equity, rather than a balanced capital structure that would benefit ratepayers through inclusion of lower cost debt rather than being weighted on the side of the owners. We also will adopt Staff's recommended fair value adjustment of -1.10 percent as a just and reasonable means of ensuring that New River does not over-recover for inflation. As a result, we will adopt Staff's recommended FVROR of 7.80 percent.

C. Cost of Capital Summary

Cost of Debt	N/A
Cost of Equity	8.90%
Fair Value Adjustment	-1.10%
Fair Value Rate of Return	**7.80%**

. . .

. . .

. . .

[65] Official notice is taken that Arizona Water Company's Eastern Group rate case, Docket No. W-01445A-11-0310, continues to be litigated, under A.R.S. § 40-252, with hearings being held at the end of November 2013.

[66] Official notice is taken that in addition to the listed decisions identified by Staff as having involved settlement agreements (Decision Nos. 72723, 73145, 73142, and 73183), Decision No. 73144 also involved a settlement agreement. Additionally, it is noted that Decision No. 73142 did not actually involve a settlement agreement per se, although the parties reached agreement on all issues prior to hearing.

VII. REVENUE REQUIREMENT

Based on the discussion herein, we determine that New River's gross revenue should increase by $474,448, or 37.64 percent, as follows:

FVRB	$6,421,716
Required FVROR	7.80%
Required Operating Income	$500,894
Adjusted TY Operating Income	$208,775
Operating Income Deficiency	$292,119
Gross Revenue Conversion Factor	1.62416
Revenue Increase Required	$474,448
Percentage Revenue Increase Required	37.64%

VIII. RATE DESIGN

New River's current rate design includes relatively low monthly usage charges, graduated by meter size; a uniform three-tiered commodity rate design applicable to all meter sizes; and relatively low commodity rates that increase very slightly between tiers. (Decision No. 65134 (August 22, 2002).) New River's rate design does not distinguish between classes of customers. (*Id.*) New River currently also has a standpipe rate set at its highest tier commodity rate. (*Id.*)

The water rates and charges for New River at present, as currently proposed, and as currently recommended by Staff are as follows:[67]

MONTHLY USAGE CHARGE:	Present Rates	Company Proposed	Staff Recommended
5/8" x 3/4" Meter	$ 7.50	$ 12.00	$ 8.00
3/4" Meter	7.50	12.00	8.00
1" Meter	18.75	30.00	20.00
1½" Meter	37.50	60.00	40.00
2" Meter	60.00	96.00	64.00
3" Meter	120.00	192.00	128.00
4" Meter	190.00	300.00	200.00
6" Meter	375.00	600.00	400.00
8" Meter	750.00	1,200.00	640.00
Standpipe Meter	N/T	By Meter Size	N/T

[67] *See* Ex. A-4 at Sched. H-3 Rej.; Ex. S-3 at Rev. Surr. Sched. CSB-41.

Commodity Rates (Per 1,000 Gallons)

All Meter Sizes			
1 to 12,000 Gallons	$ 1.20		
12,001 to 18,000 Gallons	1.40		
In excess of 18,000 Gallons	1.60		
5/8" x 3/4" Meters			
1 to 4,000 Gallons		$ 1.05	$ 0.870
4,001 to 11,000 Gallons		2.15	1.870
Over 11,000 Gallons		2.85	2.878
3/4" Meters			
1 to 4,000 Gallons		1.05	0.870
4,001 to 11,000 Gallons		2.15	1.870
Over 11,000 Gallons		2.85	2.878
1" Meter			
1 to 22,500 Gallons		2.15	
Over 22,500 Gallons		2.85	
1 to 16,000 Gallons			1.870
Over 16,000 Gallons			2.878
1 ½" Meter			
1 to 45,000 Gallons		2.15	
Over 45,000 Gallons		2.85	
1 to 30,000 Gallons			1.870
Over 30,000 Gallons			2.878
2" Meter			
1 to 72,000 Gallons		2.15	
Over 72,000 Gallons		2.85	
1 to 48,000 Gallons			1.870
Over 48,000 Gallons			2.878
3" Meter			
1 to 144,000 Gallons		2.15	
Over 144,000 Gallons		2.85	
1 to 105,000 Gallons			1.870
Over 105,000 Gallons			2.878
4" Meter			
1 to 225,000 Gallons		2.15	
Over 225,000 Gallons		2.85	
1 to 170,000 Gallons			1.870
Over 170,000 Gallons			2.878

6" Meter			
1 to 450,000 Gallons		2.15	
Over 450,000 Gallons		2.85	
1 to 360,000 Gallons			1.870
Over 360,000 Gallons			2.878
8" Meter			
1 to 720,000 Gallons		2.15	
Over 720,000 Gallons		2.85	
1 to 590,000 Gallons			1.870
Over 590,000 Gallons			2.878
Standpipe Water			
All usage	$1.60	$2.85	N/T

SERVICE LINE AND METER INSTALLATION CHARGES:
(Refundable pursuant to A.A.C. R14-2-405)

		COMPANY PROPOSED AND STAFF RECOMMENDED		
	Present[68]	Service Line Charge	Meter Installation	Total
5/8" x 3/4" Meter	$ 410.00	$ 445.00	$ 155.00	$ 600.00
3/4" Meter	410.00	445.00	255.00	700.00
1" Meter	520.00	495.00	315.00	810.00
1 ½" Meter	660.00	550.00	525.00	1,075.00
2" Turbine Meter	1,155.00	830.00	1,045.00	1,875.00
2" Compound Meter	1,720.00	830.00	1,890.00	2,720.00
3" Turbine Meter	1,625.00	1,045.00	1,670.00	2,715.00
3" Compound Meter	2,260.00	1,165.00	2,545.00	3,710.00
4" Turbine Meter	2,500.00	1,490.00	2,670.00	4,160.00
4" Compound Meter	3,200.00	1,670.00	3,645.00	5,315.00
6" Turbine Meter	4,500.00	2,210.00	5,025.00	7,235.00
6" Compound Meter	6,300.00	2,330.00	6,920.00	9,250.00
8" Meter	8,200.00	N/T	N/T	N/T
8" or Larger Meter	N/T	Cost[a]	Cost[a]	Cost[a]

SERVICE CHARGES:

	Present	Company Proposed	Staff Recommended
Establishment	$25.00	$30.00	$30.00
Establishment (After Hours)	$35.00	N/T	N/T
Reconnection (Delinquent)	$35.00	$40.00	$40.00
After Hours Charge	N/T	$25.00	$25.00
Meter Test (If Correct)	$40.00	$40.00	$40.00
Deposit	*	*	*
Deposit Interest	*	*	*

[68] New River's current tariff does not separate service line charges and meter installation charges.

Reestablishment (Within 12 Months)	**	**	**
NSF Check	$15.00	$15.00	$15.00
Deferred Payment (Per Month)	1.50%	1.50%	1.50%
Meter Re-Read (If Correct)	$20.00	$30.00	$30.00
Late Payment Penalty (Per Month)	1.50%	1.50%	1.50%
Monthly Service Charge for Fire Sprinkler (All Sizes)	***	****	N/T
Moving Customer Meter at Customer Request	N/T	Cost[a]	Cost[a]

* Per A.A.C. R14-2-403(B).
** Months off system times the monthly minimum per A.A.C. R14-2-403(D).
*** 1% of the monthly minimum charge for a comparably sized meter connection, but no less than $5.00 per month. The Service Charge for Fire Sprinklers is only applicable for service lines separate and distinct from the primary water service line.
**** 2% of the monthly minimum charge for a comparably sized meter connection, but no less than $10.00 per month. The Service Charge for Fire Sprinklers is only applicable for service lines separate and distinct from the primary water service line.
[a] All items billed at cost shall include labor, materials and parts, overheads, and all applicable taxes.
N/T No tariff
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 A.A.C. R14-2-409(D)(5).

New River's proposed rates and Staff's recommended rates would have the following impacts on monthly bills for customers served by 5/8" x 3/4" meters with average and median water usage:[69]

New River				
Monthly Usage	Current Bill	Proposed Bill	Dollar Increase	Percent Increase
Average (11,183 gal.)	$20.92	$31.77	$10.85	51.86%
Median (8,762 gal.)	$18.01	$26.44	$8.43	46.81%
Staff				
Monthly Usage	Current Bill	Proposed Bill	Dollar Increase	Percent Increase
Average (11,183 gal.)	$20.92	$25.10	$4.18	19.98%
Median (8,762 gal.)	$18.01	$20.38	$2.37	13.16%

New River has criticized Staff's recommended rate design as too heavily reliant upon highest tier commodity usage, which Mr. Jones stated would result in New River's inability to earn its revenue requirement. (Tr. at 38.) Mr. Jones asserted that Staff's rate design, as compared to New River's proposed rate design, is very steeply inverted and also departs too drastically from the current

[69] *See* Ex. A-4 at Sched. H-4 Rej.; Ex. S-3 at Rev. Surr. Sched. CSB-42.

rate design. (*Id.* at 40.) Mr. Jones testified that while the parties agree that New River's rate design needs to become more conservation-oriented, they differ as to how much more conservation-oriented it should become in this rate case. (*See id.* at 41-42.) Mr. Jones explained that while New River's proposed rate design increases the monthly service charge by approximately the same percentage as the overall proposed revenue increase, Staff's recommended rate design increases the monthly service charge by only 5.8 percent, which is starkly different from Staff's overall recommended revenue increase of 37.3 percent and, Mr. Jones stated, a "mismatch" that is unjustified in the absence of evidence that New River's current rates are collecting too much revenue through monthly minimum charges. (*Id.* at 42-43.) Mr. Jones also asserted that New River's rate design included monthly minimum charges consistent with the standard American Water Works Association ("AWWA") meter multipliers traditionally used and that Staff's rate design should not depart from this practice without "a compelling reason." (Ex. A-4 at 16.) Mr. Jones also criticized Staff's commodity rates as "wildly different" from tier to tier and suggested that Staff's rate design would cause revenue instability because it relies too greatly on revenue collected through the highest commodity rate. (Tr. at 44.) Mr. Jones testified that New River's concern is not the absolute prices, but that the steeper increases between tiers will result in significant water conservation efforts at the higher tier, jeopardizing revenues and also "driv[ing] massive amounts of revenue into the summer, and . . . mak[ing] the differences between summer and winter revenues even greater." (*See id.* at 45-47.)

At hearing, Mr. Jones presented an exhibit analyzing New River's current rates, New River's proposed rates, and Staff's recommended rates in terms of the revenue collected through base charges, the lower tier (or two lower tiers combined for small meter sizes), and the higher tier (or third tier for small meter sizes) as well as the increases represented for each through the different rate designs. (*See* Ex. A-7; Tr. at 38-39.) The exhibit shows that New River's proposed rate design is intended to generate 35.2 percent of the revenue increase through the base charge increase, 27.3 percent of the revenue increase through the lower tier/s increase, and 37.5 percent of the revenue increase through the higher tier increase, whereas Staff's recommended rate design is intended to generate 5.6 percent of the revenue increase through the base charge, 16.5 percent of the revenue

increase through the lower tier/s, and 77.9 percent of the revenue increase through the higher tier increase. (Tr. at 46.) The exhibit also shows that New River's current rates collect 36.2 percent of total revenue through the base charge, 35.6 percent of total revenue through the lower tier/s, and 28.1 percent of total revenue through the higher tier; that New River's proposed rate design would bring these to 35.9 percent, 32.4 percent, and 31.7 percent, respectively; and that Staff's recommended rate design would bring these to 27.9 percent, 30.4 percent, and 41.6 percent, respectively. (*See* Ex. A-7.) Mr. Jones opined that base charges should be at least 40 percent of total revenue, although he did not push for that in this case because he believes that New River needs a more steeply conservation-oriented rate design and that it is not possible to accomplish everything at once without causing revenue instability. (Tr. at 48-49.) Mr. Jones asserted that if Staff's recommended rate design is adopted, New River will not have a reasonable opportunity to earn its rate of return. (*Id.* at 49.)

Staff's rate design initially contained errors causing it to produce significantly more revenue than Staff had recommended for New River. (Ex. A-4 at 15.) Staff corrected its rate design in revised surrebuttal schedules filed on September 5, 2013. (*See* Ex. S-3.) In correcting its rate design to produce Staff's recommended revenue requirement, Staff reduced its recommended monthly minimum charge for 5/8" x 3/4" meter customers and 3/4" meter customers from $12.40 to $8.00, or by 35 percent, while reducing the monthly minimum charges for other meter sizes by less than 10 percent. (*See* Ex. S-2 at Sched. CSB-41; Ex. S-3 at Rev. Surr. Sched. CSB-41.) Staff also made small reductions to the tier break-over points for meter sizes larger than 1". (*See* Ex. S-2 at Sched. CSB-41; Ex. S-3 at Rev. Surr. Sched. CSB-41.) Additionally, Staff reduced the commodity rates for all customers, by 13 percent for the first tier for 5/8" x 3/4" and 3/4" meter customers; by 6.5 percent for the second tier for 5/8" x 3/4" and 3/4" meter customers (the first tier for all other customers); and by 7.8 percent for the highest tier. (*See* Ex. S-2 at Sched. CSB-41; Ex. S-3 at Rev. Surr. Sched. CSB-41.) Staff did not dispute New River's analysis of how Staff's rate design would produce Staff's recommended revenue requirement, and Staff did not perform that analysis itself. (*See* Tr. at 359-60.)

New River's customers have relatively high usage, and we agree with New River and Staff that it is appropriate to modify New River's rate design so as to encourage additional water

conservation. We also believe that maintaining a low commodity rate for very minimal usage is appropriate for customers served by the smallest meter sizes, to ensure that those who use water only sparingly may continue to do so affordably. However, we also believe that it is appropriate to adopt a more moderately revised rate design than the one proposed by Staff. We are concerned that Staff's rate design, due to its high concentration of revenues in the higher tier commodity rate, may have the unintended consequence of destabilizing New River's revenue, which would benefit neither New River nor its customers. Thus, we will adopt a more hybrid rate design, as follows:

MONTHLY USAGE CHARGE:

5/8" x 3/4" Meter	$ 9.00
3/4" Meter	9.00
1" Meter	22.50
1½" Meter	45.50
2" Meter	72.50
3" Meter	144.50
4" Meter	228.50
6" Meter	450.50
8" Meter	750.50
Standpipe Meter	By Meter Size

COMMODITY RATES
(Per 1,000 Gallons)

5/8" x 3/4" Meters	
1 to 4,000 Gallons	$ 0.95
4,001 to 10,000 Gallons	1.90
Over 10,000 Gallons	2.63
3/4" Meters	
1 to 4,000 Gallons	0.95
4,001 to 10,000 Gallons	1.90
Over 10,000 Gallons	2.63
1" Meter	
1 to 20,000 Gallons	1.90
Over 20,000 Gallons	2.63
1 ½" Meter	
1 to 40,000 Gallons	1.90
Over 40,000 Gallons	2.63
2" Meter	
1 to 65,000 Gallons	1.90

Over 65,000 Gallons	2.63
<u>3" Meter</u>	
1 to 130,000 Gallons	1.90
Over 130,000 Gallons	2.63
<u>4" Meter</u>	
1 to 200,000 Gallons	1.90
Over 200,000 Gallons	2.63
<u>6" Meter</u>	
1 to 420,000 Gallons	1.90
Over 420,000 Gallons	2.63
<u>8" Meter</u>	
1 to 670,000 Gallons	1.90
Over 670,000 Gallons	2.63
<u>Standpipe Water</u>	
All usage	2.63

<u>SERVICE CHARGES</u>:

Establishment	$30.00
Reconnection (Delinquent)	$40.00
After Hours Service Charge	$25.00
Meter Test (If Correct)	$40.00
Deposit	*
Deposit Interest	*
Reestablishment (Within 12 Months)	**
NSF Check	$15.00
Deferred Payment (Per Month)	1.50%
Meter Re-Read (If Correct)	$30.00
Late Payment Penalty (Per Month)	1.50%
Monthly Service Charge for Fire Sprinkler (All Sizes)	***
Moving Customer Meter at Customer Request	Cost[a]

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

** Months off system times the monthly minimum per A.A.C. R14-2-403(D).

*** 2% of the monthly minimum charge for a comparably sized meter connection, but no less than $10.00 per month. The Service Charge for Fire Sprinklers is only applicable for service lines separate and distinct from the primary water service line.

[a] All items billed at cost shall include labor, materials and parts, overheads, and all applicable taxes.

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 A.A.C. R14-2-409(D)(5).

These rates are designed to generate 31.3 percent of revenues from the monthly minimum charge and, for the commodity portion of revenues, to generate 24.49 percent through small meter first tier rates, 60.54 percent through small meter second tier and larger meter first tier rates, and 14.97 percent through the highest tier rates.[70] This will result in greater revenue stability than would Staff's recommended rate design. Additionally, the monthly minimum charges closely approximate what would be produced using the AWWA meter multipliers advocated by New River, and the rate design uses tier break-over points that fall between those advocated by New River and Staff. The rate design is intended to be consistent with the conservation-oriented nature of the rate design recommended by Staff, while moderating it to provide greater revenue stability. The rate design will have the following estimated bill impacts for customers served by 5/8" x 3/4" meters:

Monthly Usage	Current Bill	New Bill	Dollar Increase	Percent Increase
Average (11,183 gal.)	$20.92	$27.31	$6.39	30.54%
Median (8,762 gal.)	$18.01	$21.85	$3.84	21.32%

While these bills are higher than those produced by Staff's recommended rates, they are significantly lower than those produced by New River's proposed rates, and they remain relatively low for the level of usage represented. The rate design adopted herein will produce the revenue authorized herein.

IX. EMERGENCY PURCHASED WATER SURCHARGE & TARIFF

Because of New River's need to purchase water from the City of Peoria on an emergency basis to maintain service to New River's customers during its March 2013 well outages, Staff initially recommended that New River be authorized to adopt an Emergency Purchased Water Surcharge Tariff, using a form Ms. Brown included with her direct testimony in this case. (Ex. S-1 at 54, ex. A.) This tariff would have applied in the event New River experienced extreme water shortages and would have authorized New River, after obtaining Staff approval of the surcharge calculation, to add an emergency water surcharge as a separate line item on its customers' bills in the month following Staff approval. (Ex. S-1 at ex. A.) The tariff would have required New River to submit to Staff, with

[70] For overall revenue production, the estimated breakdown is 31.30 percent, 16.82 percent, 41.59 percent, and 10.28 percent.

its surcharge calculation, "a detailed explanation and documentation to support the fact that New River had indeed experienced an extreme water shortage." (*Id.*) The tariff also would have required New River to "undertake reasonable efforts to minimize the quantity of water purchased." (*Id.*)

New River subsequently provided Staff with a revised version of the tariff, in response to a data request from Staff. (Ex. S-2 at 30-31.) As a result, on surrebuttal, Staff withdrew its Emergency Purchased Water Surcharge Tariff and recommended that New River's version of the tariff be approved instead. (*Id.*) Ms. Brown stated that New River's tariff captures the cost savings experienced by New River as a result of not pumping water, which Staff's tariff did not. (*Id.* at 30.) Staff has now recommended adoption of New River's proposed tariff, which was attached to Ms. Brown's initial surrebuttal testimony and is attached hereto as Exhibit A. (*Id.* at 31, att.)

New River's proposed Purchased Water Surcharge Tariff Schedule, attached hereto as Exhibit A, imposes upon New River requirements that are substantially similar to the requirements imposed by Staff's originally recommended tariff form, and with additional detail provided that enhances the clarity of the tariff provisions. New River's proposed tariff does not, however, expressly require New River to provide notice to Staff before New River includes a purchased water surcharge on customer bills. (*See* Ex. S-2 at att.) Thus, while we will generally approve New River's proposed tariff, we will also require New River to modify § IV(B) in its proposed tariff by adding a requirement for New River to provide Staff notice <u>before</u> any month in which New River intends to bill customers a purchased water surcharge. It is just and reasonable to approve New River's proposed tariff, as set forth in Exhibit A hereto, with the modification described herein, and we will do so. New River will be required to file a conforming tariff that includes the required modification.

X. BEST MANAGEMENT PRACTICES

New River is enrolled as a regulated Tier I municipal provider in ADWR's Modified Non-Per Capita Conservation Program and, as such, was required by ADWR to implement a Public Education Program and one additional BMP. (Ex. S-6 at ex. MSJ at 6.) Staff received a copy of the ADWR approval of the Public Education Program and BMP 4.2—Meter Repair and Replacement Program during its field inspection at New River and determined that the BMPs had been approved by ADWR on June 24, 2010, but had not been approved in tariff form. (*Id.*) Staff has recommended that New

River be required to file with Docket Control, as a compliance item in this Docket, within 90 days after the effective date of a decision in this matter, at least seven BMPs, in the form of tariffs that substantially conform to the templates created by Staff and available on the Commission's website, for Commission review and approval. (*Id.*) Staff has also recommended that New River be permitted to submit its two ADWR-approved BMPs as two of the seven BMPs required and that New River be permitted to request cost recovery of the actual costs associated with its implemented BMPs in its next general rate application. (*Id.*)

New River has objected to Staff's BMP recommendation, asserting that requiring additional BMPs would be "duplicative and excessive" because New River is already complying with ADWR's requirements, and ADWR is the agency directly charged with regulating groundwater use; New River does not have excessive water loss; New River already has a water conservation program conforming to ADWR's requirements; and New River is already required to file reports with ADWR concerning New River's water conservation efforts. (*See* Ex. A-3 at 26.) New River further asserted that the Commission has not consistently required adoption of BMPs in its recent decisions, citing Decision No. 73573 (November 21, 2012), in which the Commission declined to impose BMP requirements on Pima Utility Company ("Pima") because Pima is in the Phoenix AMA, groundwater protection laws already exist and are enforced by ADWR, and duplicative regulation is not in the public interest. (Ex. A-3 at 26.)

On surrebuttal, Staff maintained its recommendation for New River to be required to submit a total of seven BMPs, in tariff form, for Commission review and approval. (Ex. S-7 at 3-5.) Mr. Smith explained that Staff adopted a uniform guideline for BMPs in April 2011 and, since that time, has been recommending that Class B utilities be required to implement seven BMPs. (*Id.* at 5.) Mr. Smith asserted that the Commission's imposing additional BMP requirements is not duplicative of ADWR's regulatory oversight because the Commission "requires the BMPs be filed in tariff form for implementation, notification of water company/customer requirements, and notification of steps for service termination, if needed," requirements not imposed by ADWR, according to Mr. Smith. (*Id.*) Mr. Smith also stated that having Commission-approved BMP tariffs gives a water company more tools to prevent water loss while imposing little or no extra costs. (*Id.*) Mr. Smith compared Staff's

recommendation for BMP tariffs to Staff's recommendation for backflow prevention tariffs, explaining that while backflow prevention falls under ADEQ's regulatory authority, a water utility must implement the ADEQ requirement by filing a backflow prevention tariff, which provides notification of requirements for the utility and its customers and the steps for service termination, if needed. (*Id.* at 6.)

Because New River's customers have a relatively higher level of consumption than is usual,[71] in spite of New River's already having adopted a total of two BMPs as required by ADWR, we find that it is reasonable and appropriate to require New River to adopt five additional BMPs as recommended by Staff, with the proviso that New River shall endeavor to adopt BMPs that focus upon stanching wasteful consumption by customers. New River will be required to file all seven BMPs, in the form of tariffs, for Commission review and approval.

XI. INTER-AFFILIATE TRANSFERS OF FUNDS

While auditing New River's books, Staff determined that New River had identified the amount of $1,018,247 as a debt owed to New River by Cody Farms. (Ex. A-18.) Staff considered this amount to represent a loan and issued a data request to obtain more information concerning the repayment history for the loan, the current balance on the loan, the reason behind the loan, and the terms of the loan. (*Id.*) New River responded as follows:

> a. The debt has not been repaid. The balance as of December 31, 2012, was $1,160,704.36.
>
> b. The debt is not a loan in the traditional sense and was not incurred for a particular purpose. The debt would be more properly characterized as an intercompany balance, similar to what would be recorded between a parent and its subsidiary or between subsidiary companies when cash is transferred from a subsidiary to the parent or another subsidiary and vice versa.
>
> c. There are no regular payments. Rather, the balance is increased when cash is paid out to or on behalf of Cody Farms and decreased when cash or uncompensated services (e.g., unpaid management fees) are received from Cody Farms. Interest is recorded monthly at the short-term Applicable Federal Rate published monthly by

[71] We note that among New River's 5/8" x 3/4" meter customers, approximately 10 percent of total bills during the TY were for monthly consumption higher than 21,000 gallons, and those bills represented approximately 27.6 percent of total consumption within the class. (*See* Ex. A-2 at Sched. H-5.) New River's three 3/4" meter customers had TY average monthly consumption of 41,194 gallons and median monthly consumption of 18,000 gallons and would have had much higher numbers if not for 16 bills with no usage during the TY. (*See id.*)

the Internal Revenue Service.[72]

At hearing, Mr. Jones elaborated further on New River's position, stating the following:

> . . . That balance represents a flow of cash from New River to Cody Farms.
>
> . . . .
>
> . . . It's analogous to a dividend. This balance could be eliminated by issuing a dividend, or it could have been avoided by issuing a series of dividends or distributions instead of tracking it as an intercompany balance. So they're related. I don't know that it's exactly the same thing. But I think that – and the reason that maybe I don't consider them exactly the same, the stockholders are Mr. and Mrs. Fletcher personally, and so a distribution would have had to have been to them personally, whereas my understanding is these flows of cash went to Cody Farms and not to Mr. and Mrs. Fletcher personally. But had the same exact cash been transferred to their personal bank account rather than to a Cody Farms bank account, this balance wouldn't exist.
>
> Q. And would there be anything that would preclude New River from issuing that type of dividend to the Fletchers?
>
> A. No. That would be entirely reasonable and normal practice of many utilities, is to issue dividends on a regular basis.[73]

Mr. Jones acknowledged that New River's general ledger identified the funds transferred to Cody Farms by New River as a loan and stated that New River began making these transfers of cash to Cody Farms sometime after New River's last rate case, but before the TY herein, "simply [as] a mechanism to distribute earnings of the company to the shareholders ultimately." (Tr. at 131.) According to Mr. Jones, money has flowed both to and from New River, as the Fletchers have determined to be prudent, and the Fletchers will continue to have money flow in this manner if they believe it necessary.[74] (Tr. at 153-56.) Mr. Jones also testified that the Fletchers do not consider the balance to be a debt and do not intend to pay the funds back to New River. (*Id.* at 155.) According to Mr. Jones, there is no promissory note or other writing regarding the terms of the transfers. (*Id.* at 132.) However, New River's general ledger shows a "nominal" interest component for the debt, something that Mr. Jones stated is not typical for intercompany balance transfers, that he could not explain, and that he agreed "doesn't make any sense." (*Id.* at 132, 156.) When asked about any tax advantage that might be realized through the transfers of funds, Mr. Jones stated that the

---

[72] Ex. A-18.

[73] Tr. at 81-82.

[74] For example, Mr. Jones testified that the Fletchers had infused $100,000 into New River in July 2013 because New River had a cash shortfall and could not pay all of its bills. (*Id.* at 156.)

intercompany transfer was not a taxable event for New River; that he was unsure whether it was a taxable event for Cody Farms; that he did not know why New River did not simply pay the Fletchers a dividend or distribution; and that he believed a dividend or distribution payment would not impact Mr. Fletcher's tax liability because New River is an S corporation, and the Fletchers would already be required to report and pay income tax on all of the profit realized by New River, regardless of whether a dividend or distribution was paid. (*Id.* at 132-33, 154-55.) Mr. Jones stated that Mr. Fletcher had told him many times that they "run everything through the farm." (*Id.* at 134, 155.) Mr. Jones attributed the characterization of the transfers in New River's books to Mr. Fletcher and New River's outside accountant and advisers.[75] (*Id.* at 131, 155.)

Staff characterized the transfer of funds as a loan that needs to be repaid to New River because of the manner in which New River chose to record it—as a note receivable. (Tr. at 305.) Ms. Brown testified that Staff merely characterized the balance in the same manner that New River had characterized it in its books, as a note receivable, meaning that money was to be received by New River in the future from another entity, in this case its owner. (*Id.* at 305-06.) Ms. Brown further testified that if New River did not intend to have the funds paid back, "it should have recorded it as a distribution of income, in which case, the owner would have had to pay income taxes on that income." (*Id.* at 306.) Staff did not know whether the funds had been included as income on the Schedule K-1s filed with the IRS for New River. (*Id.* at 307.) Ms. Brown also testified that any equity withdrawal would be a stock buy-back, but that no stock had been bought back from the owner in this case. (*Id.* at 306-07.) According to Ms. Brown, New River seemed to be "conflicted" regarding how to characterize the balance because it had characterized the balance as a note receivable in its books and application but then had testified that the balance was more like income and was unable to explain why it had not been recorded as a distribution. (Tr. at 307-08.) Ms. Brown agreed that the owner can take cash from the company, but asserted that it should be recorded correctly and also that doing so can harm ratepayers if it results in the company's lacking the funds needed to pay for repairs and maintenance activities, such as the tank painting that New River

[75] In his rebuttal testimony, Mr. Jones stated: "The fact that New River's outside accountant has chosen to track these distributions in an asset account labeled as a loan rather than as a deduction to its capital accounts is irrelevant." (Ex. A-3 at 25.)

delayed due to lack of funds. (Tr. at 308-09.)

Staff has recommended that the balance be treated as a loan from New River to Cody Farms and that the owners be required to pay back the loan. (Ex. S-2 at 29-30.) Specifically, Staff has recommended that New River amortize the loan for a term of at least 30 years and that the owners begin repaying the loan according to the amortization schedule within 60 days after the date of the decision in this matter. (Ex. S-1 at 31.) Staff has also recommended that New River cease making loans to the owners and that the Commission impute the payments as revenue to New River if the owners fail to repay the loan according to the amortization schedule. (*Id.*) Alternatively, Staff has recommended that the transaction be deemed either a distribution of income to the Fletchers as shareholders, for which Staff asserted they would have income tax liability, or a stock buyback. (Staff Br. at 21.) Staff characterized New River's contention that the amount is an intercompany balance transfer rather than a loan as a "distinction without a difference." (Staff Br. at 22.)

As previously discussed, New River, as a regulated water utility, is required to maintain books and records that reflect "its properties, operating income and expense, assets and liabilities, and all other accounting and statistical data necessary to give complete and authentic information as to its properties and operations" and is required to comply with the NARUC USOA.[76] (A.A.C. R14-2-411(D)(1) and (2).) The disputed characterization of the transfers of funds to Cody Farms from New River, the net balance of which exceeds $1 million, is another example of New River's failure to comply with its recordkeeping obligations. It also appears to be another example of New River's owners making decisions that put their personal interests ahead of those of New River and its ratepayers. While Mr. Jones testified that the Fletchers put money into New River as needed, something that is supported by New River's 100-percent equity capital structure, the fact remains that New River chose to record these transfers of funds to Cody Farms in a misleading (at best) manner, even going so far as to have interest on the "debt" recorded. Yet Mr. Jones testified that the Fletchers and Cody Farms never had any intention of repaying the funds to New River and have no intention of doing so now. It is unclear what benefit is derived from this purposeful mischaracterization.[77] The

[76] The NARUC USOA has standards for the accounting of items such as notes receivable from associated companies and investments in associated companies. (*See* NARUC USOA at 60-66.)

[77] The evidence was unclear concerning whether tax advantages would be derived, what they would be, and for whom.

Fletchers chose not to provide testimony in this matter, so they have not stated their intentions or explained their reasons for these transfers. What is clear is that New River has failed to account properly for the transfers of funds, in violation of both A.A.C. R14-2-411(D)(1) and (2). Staff's recommended consequence for this is to treat the balance as an outstanding loan balance and require New River to collect on it, with further consequences to result to New River (imputation of income) if New River fails to collect according to a 30-year amortization schedule. While Staff's recommendation has merit, we find it appropriate to require New River to resolve this discrepancy, and we will leave the record in this case open and will require New River to make filing/s herein notifying the Commission both of its plan to resolve the discrepancy, which plan must be acceptable to Staff, and of the discrepancy's resolution. Whether the outstanding balance of the transfers is treated as a legitimate loan, and the loan is repaid accordingly, as recommended by Staff, or whether New River, within the confines of all applicable laws and generally accepted accounting standards, modifies its records so that the funds transferred between New River and Cody Farms (and/or the Fletchers) are accurately recorded in compliance with the NARUC USOA and Commission standards retroactively now and consistently going forward, New River will be required to file, for Staff approval, both its plan to resolve the discrepancy and documentation establishing that the discrepancy has been resolved. At a minimum, the documentation to establish resolution of the discrepancy shall consist of an affidavit, sworn to by an expert knowledgeable concerning generally accepted accounting standards, NARUC USOA standards, and utility regulatory accounting practices, describing the actions taken to resolve the mischaracterization/s for each year in which the mischaracterization/s appeared in New River's books and including, as an attachment, copies of the specific pages of New River's books on which the modifications were made along with any additional relevant supporting documentation (such as proof of loan payment, if New River chooses to treat the outstanding balance as a legitimate loan). Additionally, in its next rate case, New River's books will be scrutinized for correction of these mischaracterizations and, if they or similar discrepancies are found to exist, consequences, which could include imposition of a fine or even initiation of an action to explore appointing an interim manager, may be imposed.

. . .

Finally, because these transfers again represent non-arm's length transactions that may not have been made after a determination that they were in New River's best interests, we will require New River to file, for Staff approval, a plan to ensure that any future transaction entered into with an affiliated entity is in New River's best interests.

* * * * * * * * * *

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 November 29, 2012, New River filed with the Commission a permanent rate application using a TY ending December 31, 2011. New River modified its application on December 21, 2012.

2. On December 28, 2012, Staff filed a Letter of Sufficiency for New River's rate application.

3. On January 3, 2013, a Procedural Order was issued scheduling the evidentiary hearing in this matter to commence on September 9, 2013, and establishing other procedural requirements and deadlines.

4. Notice of this matter was published in the *Peoria Times* on February 8, 2013, and was mailed to New River's customers on or about February 4, 2013.

5. On July 17, 2013, New River filed a Request to Extend Deadline for Filing Rebuttal Testimony, requesting that its deadline be extended to July 22, 2013, and stating that Staff had agreed to the requested extension. The request was granted by a Procedural Order issued on July 18, 2013.

6. On September 4, 2013, the Prehearing Conference for this matter was held. At New River's request, it was determined that the first scheduled day of hearing, September 9, 2013, would be used for public comment only and that the evidentiary hearing would commence on the second scheduled day of hearing, September 12, 2013.

7. On September 9, 2013, the hearing was convened to receive public comment, and two individuals provided comment on New River's rate application.

. . .

8. On September 12 and 13, 2013, the evidentiary hearing for this matter was held before a duly authorized Administrative Law Judge of the Commission at the Commission's offices in Phoenix, Arizona. New River appeared through counsel and provided the testimony of Mr. Jones. Staff appeared through counsel and provided the testimony of Mr. Smith, Mr. Cassidy, and Ms. Brown. At the conclusion of the hearing, New River requested to file one LFE and was directed to file another LFE to provide specified information. At the request of the parties, a briefing schedule was established that required initial briefs to be filed by October 25, 2013, and responsive briefs to be filed by November 8, 2013. The parties were advised that the extended deadline for the initial briefs would likely result in an extension of the timeframe for the decision in this matter.

9. On September 30, 2013, New River filed its LFEs, which were subsequently revised through a Notice of Errata filed on October 1, 2013.

10. On October 21, 2013, a Procedural Order was issued extending the Commission's timeframe in this matter by 21 days due to the extended filing deadlines provided for the parties' briefs.

11. On October 25, 2013, Staff filed Staff's Opening Brief, and New River filed its Initial Closing Brief.

12. On November 8, 2013, Staff filed Notice that Staff would not be filing a Reply Brief, and New River filed its Response Brief.

13. Between March 4, 2013, and October 29, 2013, approximately 89 customer comments were filed in this docket, some duplicates, with 86 opposing New River's requested rate increase.

14. No requests for intervention were filed in this matter.

15. New River is an Arizona S corporation and a Class B water utility providing water service to approximately 2,924 connections pursuant to authority granted by the Commission.

16. New River is wholly owned and controlled by Robert and Karen Fletcher, who also wholly own and control Cody Farms.

17. New River's FVRB is $6,421,716, which the Commission determined using the following adjusted OCRB and RCNRB figures:

. . .

Adjusted OCRB:	$2,225,725
Adjusted RCNRB:	$10,617,707
Adjusted FVRB:	$6,421,716

18. New River had the following TY revenues, operating expenses, and operating income:

Adjusted TY Revenues:	$1,260,428
Adjusted TY Operating Expenses:	$1,051,653
Adjusted TY Operating Income:	$208,775

19. It is just and reasonable to establish New River's rates using its actual capital structure of 100 percent equity.

20. New River's FVROR is 7.80 percent, determined as follows:

Cost of Debt	N/A
Cost of Equity	8.90%
Fair Value Adjustment	-1.10%
Fair Value Rate of Return	**7.80%**

21. During the TY, New River's 5/8" x 3/4" meter customers had relatively high water consumption for the 5/8" x 3/4" meter size, with the average usage being 11,183 gallons per month and the median usage being 8,762 per month. New River's customers served by other meter sizes also have relatively high water consumption.

22. New River agrees that its customers have relatively high water consumption levels and that a more conservation-oriented rate design should be adopted for New River.

23. New River's proposed rates would increase gross revenues by $761,820, or 60.44 percent, and result in total revenues of $2,022,249.

24. New River's proposed revenue increase would produce excessive returns on New River's FVRB.

25. Staff's recommended rates would increase gross revenues by $463,422, or 36.77 percent, and result in total revenues of $1,723,850.

26. It is just and reasonable and in the public interest to approve rates and charges that would increase New River's gross revenue by $474,448, or 37.64 percent, and result in total revenues of $1,734,876.[78]

27. The rates and charges adopted herein will have the following impacts on monthly bills for customers served by 5/8" x 3/4" meters with average and median water usage:

Monthly Usage	Current Bill	New Bill	Dollar Increase	Percent Increase
Average (11,183 gal.)	$20.92	$27.31	$6.39	30.54%
Median (8,762 gal.)	$18.01	$21.85	$3.84	21.32%

28. The rates and charges approved herein are just and reasonable and in the public interest and should be adopted herein.

29. New River has adequate production and storage facilities.

30. New River's water loss is within acceptable limits.

31. New River is in compliance with Maricopa County Environmental Services Department requirements and is delivering water meeting the water quality standards of Title 40, Part 141 of the Code of Federal Regulations and Title 18, Chapter 4 of the A.A.C.

32. New River's service area is located in the Phoenix AMA. New River is in compliance with ADWR requirements governing water providers and/or community water systems.

33. New River is a regulated Tier I municipal provider in ADWR's Modified Non-Per Capita Conservation Program and has received ADWR approval of two BMPs (Public Education Program and BMP 4.2—Meter Repair and/or Replacement Program).

34. New River has an approved curtailment plan and an approved backflow prevention tariff.

35. New River is in good standing with the Commission's Compliance Section.

36. New River should be required to continue using its existing depreciation rates, which are the same as those set forth in Exhibit B, attached hereto and incorporated herein, and which

[78] This figure includes $28,787 in other operating revenues, resulting from changes in service charges. (*See* Ex. A-4 at Sched. C-1 Rej.; Ex. S-3 at Rev. Surr. Sched. CSB-21.)

include a depreciation rate of 12.5 percent for the pumping equipment account. In addition, New River should be required to implement the vintage year model for depreciation of all of its plant accounts, as discussed above.

37. New River has engaged in a number of non-arm's length transactions without first objectively determining that the transactions are in the best interests of New River and that the costs paid by New River are fair and justified.

38. The non-arm's length transactions engaged in by New River have directly benefitted New River's owners through payments made to their wholly owned affiliate, Cody Farms, which has no other local operations.

39. New River should be required to file in this docket, within 60 days after the date of this decision, for Staff approval, a plan (1) describing the policies and procedures that New River will adopt to ensure that New River makes a good faith and reasonable effort to ensure the following: (a) that any transaction New River enters into with an affiliated individual or entity involves, for any item or service obtained from the affiliated individual or entity, only charges made at an objectively documented fair market rate; and (b) that any transaction New River enters into with an affiliated individual or entity is entered into with the affiliated individual or entity, rather than with an unaffiliated third party, only because New River has determined that the affiliated transaction will better enhance New River's provision of adequate and reliable service to its ratepayers; and (2) establishing a timeline for New River to complete and fully implement each of the policies and procedures described.

40. New River has failed to maintain its books and records in compliance with A.A.C. R14-2-411(D) and the NARUC USOA.

41. New River should be required to file in this docket, within 60 days after the date of this decision, for Staff approval, a plan describing the actions New River will take to maintain its books and records in compliance with A.A.C. R14-2-411(D) and the NARUC USOA. At a minimum, New River should be required to include in its plan provisions for the following:

(a) The manner in which New River personnel will obtain training on the general recordkeeping requirements of A.A.C. R14-2-411(D) and the NARUC USOA, and specifically on

how to record AIAC in accordance with the NARUC USOA and how to perform straight line depreciation using the vintage year model;

(b) A timeline for New River personnel to complete all of the training described;

(c) A description of policies and procedures that New River will adopt to ensure that source documents, such as invoices and canceled checks to support plant costs and itemized receipts to support operating expense items, are maintained in an organized fashion and not destroyed or thrown away; and

(d) A timeline for New River to complete and fully implement each of the policies and procedures described.

42. New River should be required to use work orders when recording retirements and to ensure that each retirement work order includes at least the following information: (1) whether the retirement cost used is actual or estimated, (2) the name of the water company or system from which the plant was removed, (3) the date of retirement, (4) the NARUC account from which the plant was removed, (5) the reason for retirement, and (6) the appropriate approvals for the retirement.

43. New River should be put on notice that recovery will not be permitted in the future for credit card charges asserted to be company business expenses unless underlying itemized receipts from vendors are provided to support the nature of those charges and that they were necessary for the provision of utility services.

44. New River should be required to file, by June 2, 2014, documentation from ACAI establishing that the recoating work for New River's storage tank built in 1997 has been completed and showing the final invoiced amount for that work.

45. The current informal arrangement under which New River pays rent to Cody Farms so that New River may have access to, and use in its operations, utility facilities that are located on the 87th Ave. property owned by Cody Farms is not in the public interest, as it jeopardizes New River's ability to access and use those utility facilities going forward and thus New River's ability to continue providing adequate service to its ratepayers. Regardless of whether the charges for this access and use are characterized as rent or another type of expense (*e.g.,* management fees), the Fletchers' decision to require New River to pay Cody Farms for use of the land on which their common owners

(the Fletchers) chose to install New River's facilities is an unjust, preferential, and insufficient practice under A.R.S. § 40-203. Accordingly, the Commission finds that this unjust, preferential, and insufficient practice must end through one of several options, as discussed herein. Regardless of which option is chosen, New River may request appropriate recovery in its next rate case, and New River will be required in its next rate case to provide objective evidence establishing the fair value of the property or right transferred or obtained.

46. The informal arrangement under which New River currently rents a full-size or larger pick-up truck from Cody Farms for each full-time employee of New River, along with a forklift and two trailers that are used only sporadically, is unreasonable and not in the public interest. In future rate cases, when New River claims vehicle rental expense as an operating expense, New River should be required to provide, for each vehicle for which expense is claimed, a detailed usage log and documentation of the cost and fair value of the vehicle and the fair rental rate for the vehicle.

47. It is just and reasonable and in the public interest to authorize New River to adopt the Purchased Water Surcharge Tariff Schedule attached hereto as Exhibit A, modified to include in § IV(B) a requirement for New River to provide Staff notice before any month in which New River intends to include a purchased water surcharge on customer bills. Further, it is necessary to require New River to file the modified tariff in this docket within 30 days after the effective date of this Decision.

48. New River has adopted two BMPs as required by ADWR, but those BMPs have not been filed with the Commission in the form of tariffs. Staff has recommended that New River be required to file with Docket Control, as a compliance item in this Docket, within 90 days after the effective date of this Decision, for Commission review and approval, at least seven BMPs (two of which can be New River's adopted BMPs), in the form of tariffs that substantially conform to the templates created by Staff and available on the Commission's website. Staff's recommendation is just and reasonable and should be adopted. Additionally, New River should be required to use its best efforts to adopt BMPs that focus specifically upon stanching wasteful consumption by New River's customers.

. . .

49. New River should be permitted, in its next general rate application, to request cost recovery of the actual costs associated with its implemented BMPs.

50. Since New River's last rate case, New River has transferred funds to Cody Farms on multiple occasions, as a means of distributing New River's earnings to the Fletchers. New River has recorded these transfers, for which there is a net balance of approximately $1.1 million, as a debt owed to New River by Cody Farms, and has been recording interest accrual on the outstanding amount of the "debt." New River knows and has known that there is no promissory note or other writing regarding the terms of these transfers and also knows and has known that Cody Farms has no intention of repaying New River for the funds transferred. New River's manner of recording these transactions constituted a failure by New River to account properly for the transfer of funds, in violation of A.A.C. R14-2-411(D)(1) and (2). Staff has recommended that New River be required to collect on the recorded debt, over an amortization period of at least 30 years, and has recommended consequences to occur if New River fails to collect according to a 30-year amortization schedule. While Staff's recommendation has merit, we find it appropriate to require New River to resolve this discrepancy, and we will leave the record in this case open and will require New River to make filing/s herein notifying the Commission both of its plan to resolve the discrepancy, which plan must be acceptable to Staff, and of the discrepancy's resolution. Whether the outstanding balance of the transfers is treated as a legitimate loan, and the loan is repaid accordingly, as recommended by Staff, or whether New River, within the confines of all applicable laws and generally accepted accounting standards, modifies its records so that the funds transferred between New River and Cody Farms (and/or the Fletchers) are accurately recorded in compliance with the NARUC USOA and Commission standards retroactively now and consistently going forward, New River will be required to file, for Staff approval, both its plan to resolve the discrepancy and documentation establishing that the discrepancy has been resolved. At a minimum, the documentation to establish resolution of the discrepancy shall consist of an affidavit, sworn to by an expert knowledgeable concerning generally accepted accounting standards, NARUC USOA standards, and utility regulatory accounting practices, describing the actions taken to resolve the mischaracterization/s for each year in which the mischaracterization/s appeared in New River's books and including, as an attachment, copies of the

specific pages of New River's books on which the modifications were made along with any additional relevant supporting documentation (such as proof of loan payment, if New River chooses to treat the outstanding balance as a legitimate loan). Additionally, in its next rate case, New River's books will be scrutinized for correction of these mischaracterizations and, if they or similar discrepancies are found to exist, consequences, which could include imposition of a fine or even initiation of an action to explore appointing an interim manager, may be imposed.

CONCLUSIONS OF LAW

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

2. The Commission has jurisdiction over New River and the subject matter of the application.

3. Notice of the proceeding was provided in accordance with the law.

4. New River's FVRB is $6,421,716, and applying a 7.80 percent FVROR on this FVRB produces rates and charges that are just and reasonable.

5. The rates and charges and terms and conditions of service approved herein are just and reasonable and in the public interest.

6. It is just and reasonable and in the public interest for the Commission to take the actions and impose the requirements described in Findings of Fact Nos. 36, 39, and 41 through 50.

ORDER

IT IS THEREFORE ORDERED that New River Utility Company shall file with Docket Control, as a compliance item in this docket, before February 1, 2014, revised rate schedules setting forth the following rates and charges:

MONTHLY USAGE CHARGE:

5/8" x 3/4" Meter	$ 9.00
3/4" Meter	9.00
1" Meter	22.50
1½" Meter	45.50
2" Meter	72.50
3" Meter	144.50
4" Meter	228.50
6" Meter	450.50

8" Meter	750.50
Standpipe Meter	By Meter Size

COMMODITY RATES
(Per 1,000 Gallons)

5/8" x 3/4" Meters	
1 to 4,000 Gallons	$ 0.95
4,001 to 10,000 Gallons	1.90
Over 10,000 Gallons	2.63
3/4" Meters	
1 to 4,000 Gallons	0.95
4,001 to 10,000 Gallons	1.90
Over 10,000 Gallons	2.63
1" Meter	
1 to 20,000 Gallons	1.90
Over 20,000 Gallons	2.63
1 ½" Meter	
1 to 40,000 Gallons	1.90
Over 40,000 Gallons	2.63
2" Meter	
1 to 65,000 Gallons	1.90
Over 65,000 Gallons	2.63
3" Meter	
1 to 130,000 Gallons	1.90
Over 130,000 Gallons	2.63
4" Meter	
1 to 200,000 Gallons	1.90
Over 200,000 Gallons	2.63
6" Meter	
1 to 420,000 Gallons	1.90
Over 420,000 Gallons	2.63
8" Meter	
1 to 670,000 Gallons	1.90
Over 670,000 Gallons	2.63
Standpipe Water	
All usage	2.63

SERVICE CHARGES:

Establishment	$30.00
Reconnection (Delinquent)	$40.00
After Hours Service Charge	$25.00
Meter Test (If Correct)	$40.00
Deposit	*
Deposit Interest	*
Reestablishment (Within 12 Months)	**
NSF Check	$15.00
Deferred Payment (Per Month)	1.50%
Meter Re-Read (If Correct)	$30.00
Late Payment Penalty (Per Month)	1.50%
Monthly Service Charge for Fire Sprinkler (All Sizes)	***
Moving Customer Meter at Customer Request	Cost[a]

* Per A.A.C. R14-2-403(B).
** Months off system times the monthly minimum per A.A.C. R14-2-403(D).
*** 2% of the monthly minimum charge for a comparably sized meter connection, but no less than $10.00 per month. The Service Charge for Fire Sprinklers is only applicable for service lines separate and distinct from the primary water service line.
[a] All items billed at cost shall include labor, materials and parts, overheads, and all applicable taxes.

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 A.A.C. R14-2-409(D)(5).

IT IS FURTHER ORDERED that the above rates and charges shall be effective for all service provided on and after February 1, 2014.

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

IT IS FURTHER ORDERED that New River Utility Company shall continue to use its existing depreciation rates, which are the same as those set forth in Exhibit B, attached hereto and incorporated herein, and include a depreciation rate of 12.5 percent for the pumping equipment account.

IT IS FURTHER ORDERED that New River Utility Company shall implement the vintage year model of depreciation for all of its plant accounts.

IT IS FURTHER ORDERED that New River Utility Company shall file with the Commission's Docket Control, as a compliance item in this docket, within 60 days after the date of

this Decision, for Staff approval, a recordkeeping compliance plan in which New River Utility Company describes the actions New River Utility Company will take to maintain its books and records in compliance with A.A.C. R14-2-411(D) and the NARUC USOA. At a minimum, New River Utility Company shall include in its recordkeeping compliance plan provisions for the following:

(a) The manner in which New River Utility Company personnel will obtain training on the general recordkeeping requirements of A.A.C. R14-2-411(D) and the NARUC USOA, and specifically on how to record AIAC in accordance with the NARUC USOA and how to perform straight line depreciation using the vintage year model;

(b) A timeline for New River Utility Company personnel to complete all of the training described;

(c) A description of policies and procedures that New River Utility Company will adopt to ensure that source documents, such as invoices and canceled checks to support plant costs and itemized receipts to support operating expense items, are maintained in an organized fashion and not destroyed or thrown away; and

(d) A timeline for New River Utility Company to complete and fully implement each of the policies and procedures described.

IT IS FURTHER ORDERED that after filing its recordkeeping compliance plan in this docket, New River Utility Company shall communicate with the Commission's Utilities Division Staff as needed, make any and all modifications determined by Staff to be necessary for Staff approval of the recordkeeping compliance plan, and file in this docket and implement the recordkeeping compliance plan approved by Staff.

IT IS FURTHER ORDERED that New River Utility Company shall, within 60 days after the date of this decision, file as a compliance item in this docket, for Staff approval, a fair transactions plan (1) describing the policies and procedures that New River will adopt to ensure that New River makes a good faith and reasonable effort to ensure the following: (a) that any transaction New River enters into with an affiliated individual or entity involves, for any item or service obtained from the affiliated individual or entity, only charges made at an objectively documented fair market rate; and

(b) that any transaction New River enters into with an affiliated individual or entity is entered into with the affiliated individual or entity, rather than with an unaffiliated third party, only because New River has determined that the affiliated transaction will better enhance New River's provision of adequate and reliable service to its ratepayers; and (2) establishing a timeline for New River to complete and fully implement each of the policies and procedures described.

IT IS FURTHER ORDERED that after filing its fair transactions plan in this docket, New River Utility Company shall communicate with the Commission's Utilities Division Staff as needed, make any and all modifications determined by Staff to be necessary for Staff approval of the fair transactions plan, and file in this docket and implement the fair transactions plan approved by Staff.

IT IS FURTHER ORDERED that New River Utility Company shall use work orders when recording retirements and shall ensure that each retirement work order includes the following information: (1) whether the retirement cost used is actual or estimated, (2) the name of the water company or system from which the plant was removed, (3) the date of retirement, (4) the NARUC account from which the plant was removed, (5) the reason for retirement, and (6) appropriate approvals for the retirement.

IT IS FURTHER ORDERED that New River Utility Company is hereby put on notice that recovery will not be permitted in the future for credit card charges asserted to be company business expenses unless underlying itemized receipts are provided to support the nature of those charges and that they were necessary for the provision of utility services.

IT IS FURTHER ORDERED that New River Utility Company shall, by June 2, 2014, file with the Commission's Docket Control, as a compliance item in this docket, documentation obtained from ACAI establishing that the recoating work for New River Utility Company's storage tank built in 1997 has been completed and showing the final invoiced amount for that work.

IT IS FURTHER ORDERED that New River Utility Company shall end the current informal arrangement under which New River Utility Company pays rent to Cody Farms in return for New River Utility Company's receiving access to, and being able to use in its operations, utility facilities that belong to New River Utility Company but are located on the 87th Ave. property owned by Cody Farms, through one of several options. New River Utility Company may end this practice by having

the Fletchers transfer ownership of the land from Cody Farms to New River Utility Company. New River Utility Company may end this practice by having the Fletchers craft, execute, and record an instrument providing New River Utility Company an enforceable right to permanently access and use New River Utility Company's facilities installed on the 87th Ave. property, which right must run with the land. New River may end this practice by finding and purchasing another property upon which its facilities can be installed. Regardless of the manner in which New River Utility Company ends the practice, in its next rate case, New River Utility Company may request recovery of the fair value of the property or right transferred or obtained and shall provide objective evidence establishing the fair value of the property or right transferred or obtained.

IT IS FURTHER ORDERED that in future rate cases, when New River Utility Company claims vehicle rental expense as an operating expense, New River Utility Company shall provide, for each vehicle for which the expense is claimed, a detailed usage log and documentation of the cost and fair market value of the vehicle and the fair market rental rate for the vehicle.

IT IS FURTHER ORDERED that New River Utility Company is hereby authorized to adopt and implement the Purchased Water Surcharge Tariff Schedule attached hereto as Exhibit A, modified to include in § IV(B) a requirement for New River Utility Company to provide Staff notice before any month in which New River Utility Company intends to bill customers a purchased water surcharge.

IT IS FURTHER ORDERED that New River Utility Company shall file with the Commission's Docket Control, as a compliance item in this Docket, within 30 days after the effective date of this Decision, the Purchased Water Surcharge Tariff Schedule modified as discussed in the immediately preceding ordering paragraph.

IT IS FURTHER ORDERED that New River Utility Company shall file with Docket Control, as a compliance item in this Docket, within 90 days after the effective date of this Decision, for Commission review and approval, at least seven BMPs (two of which can be New River Utility Company's currently adopted BMPs), in the form of tariffs that substantially conform to the templates created by Staff and available on the Commission's website. New River Utility Company

shall use its best efforts to adopt BMPs that focus upon stanching wasteful consumption by its customers.

IT IS FURTHER ORDERED that New River Utility Company may, in its next general rate application, request cost recovery of the actual costs associated with its implemented BMPs.

IT IS FURTHER ORDERED that to address the approximately $1.1 million balance of funds transferred from New River Utility Company to Cody Farms and previously recorded by New River Utility Company as a note receivable, we will leave the record in this case open, and New River Utility Company shall:

(a) Determine the most appropriate manner of resolving this discrepancy, within the confines of all applicable laws and orders;

(b) File, within 90 days after the effective date of this decision, as a compliance item in this docket, for Staff approval, a discrepancy resolution plan to resolve the discrepancy in a manner that is consistent with all applicable laws and orders, generally accepted accounting standards, the NARUC USOA, and Commission standards;

(c) Within 90 days after receiving written Staff approval of its discrepancy resolution plan, fully implement the approved plan and file, as a compliance item in this docket, documentation to establish resolution of the discrepancy, which shall, at a minimum, consist of an affidavit, sworn to by an expert knowledgeable concerning generally accepted accounting standards, NARUC USOA standards, and utility regulatory accounting practices, describing the actions taken to resolve the mischaracterization/s for each year in which the mischaracterization/s appeared in New River's books and including, as an attachment, copies of the specific pages of New River's books on which the modifications were made along with any additional relevant supporting documentation (such as proof of loan payment, if New River chooses to treat the outstanding balance as a legitimate loan);

(d) Ensure that any future fund transfers of a similar nature are recorded accurately, in compliance with all applicable laws, generally accepted accounting standards, the NARUC USOA, and Commission standards; and

(e) In its next rate case, if New River Utility Company's books contain additional mischaracterizations of the same nature, or other similar discrepancies, face consequences that may include imposition of a fine or action to explore appointing an interim manager.

IT IS FURTHER ORDERED that the Commission's Utilities Division Staff shall, within 60 days after New River Utility Company files its discrepancy resolution plan, review the plan for compliance with all applicable laws and standards and file in this docket a memorandum either approving the plan or disapproving the plan and describing the modifications that must be made for the plan to be approved.

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 _____ day of _____ 2014.

JODI JERICH
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____
SH:ru

SERVICE LIST FOR: NEW RIVER UTILITY COMPANY

DOCKET NOS.: W-01737A-12-0478

Jeffrey W. Crockett
BROWNSTEIN HYATT FARBER SCHRECK, LLP
One East Washington Street, Suite 2400
Phoenix, AZ 85004
Attorneys for New River Utility Company

Janice Alward, Chief Counsel
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, AZ 85007

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

EXHIBIT A

TARIFF SCHEDULE

UTILITY: New River Utility Company
DOCKET NO. W-01737A-12-0478

DECISION NO. _____
EFFECTIVE DATE: _____

PURCHASED WATER SURCHARGE

I. Purpose and Applicability

The purpose of the this tariff is to equitably apportion the costs of water purchased through an emergency interconnection with the City of Peoria among New River Utility Company Customers. These charges are applicable to all connections and will be assessed based on usage, as more particularly provided below.

II. Definitions

Unless the context otherwise requires, the definitions set forth in R-14-2-401 of the Arizona Corporation Commission's ("Commission") rules and regulations governing water utilities shall apply in interpreting this tariff schedule.

"Avoided Production Costs" means the unit cost of production (cost per 1,000 gallons) avoided by the Company because of the use of water purchased from the City of Peoria rather than pumping groundwater from the Company's wells and booster stations.

"Company" means New River Utility Company.

"Purchased Water Cost" means the actual cost billed by the City of Peoria for water purchased through the emergency interconnection between the City of Peoria's water system and the Company's water system.

"Purchased Water Quantity" means the actual quantity (in thousands of gallons) of water billed by the City of Peoria for water purchased through the emergency interconnection between the City of Peoria's water system and the Company's water system.

"Purchased Water Surcharge" means the surcharge calculated in accordance with Section IV below.

"Surcharge Rate" means the rate per 1,000 gallons that is calculated in accordance with Section III below.

"Water Sold" means the actual quantity (in thousands of gallons) of water sold by the Company to its Customers during the month corresponding to the month in which water was purchased from the City of Peoria through the emergency interconnection between the City of Peoria's water system and the Company's water system.

III. Surcharge Rate Calculation

For each month that the Company purchases water from the City of Peoria through the emergency interconnection between the City of Peoria's water system and the Company's water system, the Company will calculate the Surcharge Rate per the following formula:

[Purchased Water Cost – (Purchased Water Quantity x Avoided Production Costs)] / Water Sold

IV. Terms and Conditions

(A) Assessment and Billing of Purchased Water Surcharge: For any month in which water is purchased from the City of Peoria, after completing its billing for the month and receiving Peoria's billing for the month, New River will make the surcharge calculation to determine the Surcharge Rate.

In the following month, New River will bill the Purchased Water Surcharge to its customers. Each individual customer's billing for the Purchased Water Surcharge will be based on that customer's actual usage for the previous month (the month corresponding to the water purchase from Peoria) times the Surcharge Rate.

The Purchased Water Surcharge shall be presented as a separate line item on the customer billing.

(B) Notice to Commission: For any month in which the Company intends to bill customers a Purchased Water Surcharge, the Company shall provide Commission Staff notice of the Company's intent to bill the Purchased Water Surcharge. The notice to Commission Staff shall include the following:

1. The Purchased Water Cost.
2. The Purchased Water Quantity.
3. A copy of the bill received for the purchase of water from the City of Peoria.
4. A description of the system problem necessitating purchasing of water and a description of the action being taken by the Company to resolve the problem, including the date operations did or are expected to return to normal.
5. The dates for beginning and ending purchasing water.
6. A schedule showing the calculation of the Surcharge Rate in excel format with formulas intact, including a schedule showing the determination of the Avoided Production Costs.

EXHIBIT B

Table I-1. Water Depreciation Rates

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

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