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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

- BOB STUMP - Chairman
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2014 MAY -2 P 4:40

AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF
VERDE SANTA FE WASTEWATER CO., INC.
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE FAIR VALUE OF
ITS UTILITY PLANTS AND PROPERTY AND
FOR INCREASES IN ITS WASTEWATER
RATES AND CHARGES FOR UTILITY
SERVICE BASED THEREON.

DOCKET NO. SW-03437A-13-0292

STAFF RESPONSE

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") files this response to several of the questions raised by Administrative Law Judge Sarah Harpring at the prehearing conference held April 29, 2014. Staff will also present testimony on these matters during the hearing.

RESPECTFULLY SUBMITTED this 2nd day of May, 2014.

Arizona Corporation Commission

DOCKETED

MAY 02 2014

DOCKETED BY

Robin R. Mitchell, Attorney
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
602) 542-3402

Original and thirteen (13) copies
of the foregoing filed this
2nd day of May, 2014 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85006

Copy of the foregoing emailed
this 2nd day of May, 2014 to:

Jay L. Shapiro
FENNEMORE CRAIG, P.C.
2394 E. Camelback Road, Suite 600
Phoenix, AZ 85016
Attorneys for Verde Santa Fe Wastewater
Co., Inc.

**ARIZONA CORPORATION COMMISSION
STAFF'S RESPONSES TO
QUESTIONS SET FORTH BY ADMINISTRATIVE LAW JUDGE**

DOCKET NO. W-03437A-13-0292

May 2, 2014

1. Plan to Transfer the \$250,000 in Plant From Pivotal to Verde Santa Fe
 - a. What process did Staff contemplate for the transference of the ownership of the plant from Pivotal to Verde Santa Fe?
 - b. What would be Staff's considerations in the approval of such a plan?

Staff Response:

Staff contemplates that Pivotal would issue a note receivable to Verde Santa Fe in the amount of \$168,750 for the book value of the plant (\$250,000 original cost - \$81,250 accumulated depreciation for 6.5 years).¹ The term of the note receivable would be 14 years (the remaining life of the plant at the end of the test year) with a 5% interest rate.

Since the \$168,750 note receivable would represent a long-term debt financial obligation for Verde Santa Fe, Commission authorization would be necessary. The financing application for the note receivable would be filed within 90 days of the date of Decision resulting from this matter. Further, Staff contemplates being able to review source documents in support of the \$250,000 in plant.

Staff's considerations in approval of the plan would be similar to a review of any other financing application.

Staff would make a filing in the docket upon the completion of its review.

¹ The NARUC Guidelines for cost allocations and Affiliate Transactions states that the transfer price of assets from an unregulated affiliate to a regulated utility should be the lower of the prevailing market price or net book value.

2. Capital vs. Operating Lease - Is the \$250,000 lease a capital or operating lease?

Staff Response:

Staff considered the following four criteria identified by what was originally the Financial Accounting Standards Board ("FASB") No. 13 "Accounting for Leases" assessing whether or not a lease is a capital lease:

- The lease transfers ownership of the property to the lessee by the end of the lease term. Based upon a review of the terms of the lease agreement, Staff found that there was no transfer of the asset without payment.
- The lease contains a bargain purchase. Based upon a review of the terms of the lease agreement, Staff found no bargain purchase option.
- The lease term is equal to 75 percent or more of the estimated economic life of the leased property. Based upon a review of the terms of the contract, Staff found that the term of the lease was 10 years whereas the estimated useful life of the asset was 20 years. Therefore, the lease term was less than 75% of the asset's useful life.
- The present value at the beginning of the lease term of the minimum lease payments equals or exceeds 90 percent of the excess of the fair value of the leased property. Based upon Staff analysis, the present value of the lease payments was less than 90% of the total original cost of the equipment.

Based upon a review of the terms of the lease agreement, the lease did not meet any of the above criteria, and therefore is an operating lease, not a capital lease.

3. \$250,000 Lease Treated As Debt - Provide the revenue requirement supported by schedules showing how the revenue requirement would be different if the \$250,000 were treated as debt rather than an operating lease.

Staff Response:

The revenue requirement is \$530,140 when the \$250,000 lease is treated as debt (see attached schedules). This is an increase of \$12,938 from the \$517,202 revenue requirement that Staff recommended in its surrebuttal testimony.

The capital structure of the Company would change if the lease were treated as debt. For purposes of this request, the debt component of the capital structure is based on a \$168,750 net book value of the plant associated with the \$250,000 equipment lease (\$250,000 - \$81,250 of A/D). The 1.7% weighted cost of debt assumes a cost of debt

of 5.0%; the 8.1% overall ROR assumes the net plant is accounted for as a capital lease:

| | Weight (%) | Cost | Weighted Cost |
|----------------------|------------|------|---------------|
| Long-Term Debt | 33.8% | 5.0% | 1.7% |
| Common Equity | 66.2% | 9.6% | 6.4% |
| Weighted Average COC | | | 8.1% |
| | | | |

4. Rate Case Expense - The Company stated that it would be filing rate cases every 3 years but normalized rate case expense using 4 years. Explain why this is appropriate.

Staff Response:

It is appropriate to normalize rate case expense using 4 years when the Company stated that it expects to file rate cases every 3 years. The additional year reflects the time it takes to process the rate application (i.e. 3 years out + 1 year to process case).

5. Compliance Issue - Staff indicated that there were no compliance issues. However, Decision No. 60779 stated that the Company was to file for a rate case within 36 months of operation.

Staff Response:

Decision No. 60779 ordered the Company to file for a *rate review* not a rate application. Staff found that the Company filed its rate review as ordered by the Commission and, therefore, is in compliance.

6. Miscellaneous Service Charge, Disconnection of Service - Staff indicated that the Company does not actually disconnect sewer service. Rather, the Company places a lien against the customer's home. What other companies place liens against customers' homes.

Staff Response:

Staff does not know of any other company that places liens against customers' homes.

7. Discuss the treatment of the bad debt of the golf course. The golf course was not paying the tariffed rate, were any adjustments made.

Staff Response:

Yes, the Company made a pro forma adjustment to remove \$63,411 in revenue that was billed to the golf course. Accordingly, the Company made a pro forma adjustment to remove \$63,411 in bad debt expense attributable to the golf course. Staff accepted the Company's adjustment.

8. In Ms. Stukov's testimony, at p. 9 of the engineering report, it states that the Company is not currently in violation at a level at which ADEQ will take action. Please provide clarification.

Staff Response:

This ADEQ statement indicates that ADEQ considers Verde Santa Fe, to be for all practical purposes, to be in compliance with ADEQ regulations, but is not in full technical compliance due to any number of minor (non-safety related) deficiencies.

9. The Status of Docket No. 09-0493—Golf Course Alternative Effluent Disposal

Staff Response:

On October 14, 2009, the Company filed with the Commission, an application for a reduction in the commodity rate for effluent sales. On October 29, 2009, Staff requested a suspension of the time clock to evaluate this tariff filing. On December 8, 2009, the Commission issued Decision No. 71429 suspending the filing through March 10, 2010. At the March 3, 2010, Open Meeting to consider the proposed recommended opinion and order, the Commission elected to defer a decision to allow Staff and the Company time to explore effluent disposal alternatives resulting from the existing recipient's unwillingness to pay the authorized tariff. On April 13, 2010, Staff filed a Staff memo detailing its recommendations resulting from its further review of the matter and a proposed order. The matter was placed on the agenda for the April 27, 2010 Open Meeting and the matter was pulled from the Agenda by the Commission.

Staff was concerned that because of the unwillingness of the effluent recipient to pay the authorized tariff rate, that in the event the recipient would no longer take the effluent, a potential health and safety risk existed. Now that Staff has recommended that the rate for effluent be set at the rate the golf course is willing to pay, which

would remove the threat that the golf course would refuse to take the effluent, Staff believes there is no longer a health and safety issue. Staff would also note that the disposal of effluent is governed by the Arizona Department of Environmental Quality, under a company's Aquifer Protection Permit ("APP"). The Company's APP does not require an alternative method of disposal.

Exhibit 1
Schedules

Verde Santa Fe Wastewater Company, Inc.
Docket No. SW-03437A-13-0292
Test Year Ended December 31, 2012

Hearing Surrebuttal Schedule CSB-1

REVENUE REQUIREMENT

| <u>LINE NO.</u> | <u>DESCRIPTION</u> | (A) COMPANY FAIR VALUE | (B) STAFF FAIR VALUE |
|-----------------|---------------------------------------|---------------------------------|-------------------------------|
| 1 | Adjusted Rate Base | \$ 421,336 | \$ 752,586 |
| 2 | Adjusted Operating Income (Loss) | \$ (3,950) | \$ 22,072 |
| 3 | Current Rate of Return (L2 / L1) | -0.94% | 2.93% |
| 4 | Required Rate of Return | 11.00% | 8.10% |
| 5 | Required Operating Income (L4 * L1) | \$ 46,347 | \$ 60,959 |
| 6 | Operating Income Deficiency (L5 - L2) | \$ 50,297 | \$ 38,888 |
| 7 | Gross Revenue Conversion Factor | 1.2966 | 1.3009 |
| 8 | Required Revenue Increase (L7 * L6) | \$ 65,213 | \$ 50,589 |
| 9 | Adjusted Test Year Revenue | \$ 479,551 | \$ 479,551 |
| 10 | Proposed Annual Revenue (L8 + L9) | \$ 544,764 | \$ 530,140 |
| 11 | Required Increase in Revenue (%) | 13.60% | 10.55% |

GROSS REVENUE CONVERSION FACTOR

| LINE NO. | DESCRIPTION | (A) | (B) | (C) | (D) |
|--|--|-----------------|-----------|------------|----------|
| <u>Calculation of Gross Revenue Conversion Factor:</u> | | | | | |
| 1 | Revenue | 100.0000% | | | |
| 2 | Uncollectible Factor (Line 11) | 0.0000% | | | |
| 3 | Revenues (L1 - L2) | 100.0000% | | | |
| 4 | Combined Federal and State Income Tax and Property Tax Rate (Line 23) | 23.1294% | | | |
| 5 | Subtotal (L3 - L4) | 76.8706% | | | |
| 6 | Revenue Conversion Factor (L1 / L5) | 1.300887 | | | |
| <u>Calculation of Uncollectible Factor:</u> | | | | | |
| 7 | Unity | 100.0000% | | | |
| 8 | Combined Federal and State Tax Rate (Line 23) | 22.0394% | | | |
| 9 | One Minus Combined Income Tax Rate (L7 - L8) | 77.9606% | | | |
| 10 | Uncollectible Rate | 0.0000% | | | |
| 11 | Uncollectible Factor (L9 * L10) | 0.0000% | | | |
| <u>Calculation of Effective Tax Rate:</u> | | | | | |
| 12 | Operating Income Before Taxes | 100.0000% | | | |
| 13 | Arizona State Income Tax Rate | 6.5000% | | | |
| 14 | Federal Taxable Income (L12 - L13) | 93.5000% | | | |
| 15 | Applicable Federal Income Tax Rate (Line 55) | 16.6197% | | | |
| 16 | Effective Federal Income Tax Rate (L14 x L15) | 15.5394% | | | |
| 17 | Combined Federal and State Income Tax Rate (L13 +L16) | | 22.0394% | | |
| <u>Calculation of Effective Property Tax Factor</u> | | | | | |
| 18 | Unity | 100.0000% | | | |
| 19 | Combined Federal and State Income Tax Rate (L17) | 22.0394% | | | |
| 20 | One Minus Combined Income Tax Rate (L18-L19) | 77.9606% | | | |
| 21 | Property Tax Factor | 1.3981% | | | |
| 22 | Effective Property Tax Factor (L20*L21) | | 1.0900% | | |
| 23 | Combined Federal and State Income Tax and Property Tax Rate (L17+L22) | | | 23.1294% | |
| 24 | Required Operating Income (Schedule CSB-1, Line 5) | \$ 60,959 | | | |
| 25 | Adjusted Test Year Operating Income (Loss) | 22,072 | | | |
| 26 | Required Increase in Operating Income (L24 - L25) | | \$ 38,888 | | |
| 27 | Income Taxes on Recommended Revenue (Col. [E], L52) | \$ 13,390 | | | |
| 28 | Income Taxes on Test Year Revenue (Col. [B], L52) | 2,396 | | | |
| 29 | Required Increase in Revenue to Provide for Income Taxes (L27 - L28) | | | 10,994 | |
| 30 | Recommended Revenue Requirement (Schedule CSB-1) | \$ 530,140 | | | |
| 31 | Uncollectible Rate (Line 10) | 0.0000% | | | |
| 32 | Uncollectible Expense on Recommended Revenue (L30*L31) | \$ - | | | |
| 33 | Adjusted Test Year Uncollectible Expense | \$ - | | | |
| 34 | Required Increase in Revenue to Provide for Uncollectible Exp. (L32-L33) | | | | |
| 35 | Property Tax with Recommended Revenue | \$ 20,822 | | | |
| 36 | Property Tax on Test Year Revenue | 20,114 | | | |
| 37 | Increase in Property Tax Due to Increase in Revenue (L35-L36) | | | 707 | |
| 38 | Total Required Increase in Revenue (L26 + L29 + L34 + L37) | | \$ 50,589 | | |
| <u>Calculation of Income Tax:</u> | | | | | |
| 39 | Revenue | \$ 479,551 | \$ 50,589 | \$ 530,140 | |
| 40 | Operating Expenses Excluding Income Taxes | \$ 455,083 | \$ 707 | \$ 455,791 | |
| 41 | Synchronized Interest (L56) | \$ 12,794 | | \$ 12,794 | |
| 42 | Arizona Taxable Income (L39 - L40 - L41) | \$ 11,674 | | \$ 61,555 | |
| 43 | Arizona State Income Tax Rate | 6.5000% | | 6.5000% | |
| 44 | Arizona Income Tax (L42 x L43) | \$ 759 | | \$ 4,001 | |
| 45 | Federal Taxable Income (L42 - L44) | \$ 10,915 | | \$ 57,554 | |
| 46 | Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15% | \$ 1,637 | | \$ 7,500 | |
| 47 | Federal Tax on Second Income Bracket (\$51,001 - \$75,000) @ 25% | \$ - | | \$ 1,888 | |
| 48 | Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34% | \$ - | | \$ - | |
| 49 | Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39% | \$ - | | \$ - | |
| 50 | Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34% | \$ - | | \$ - | |
| 51 | Total Federal Income Tax | \$ 1,637 | | \$ 9,388 | |
| 52 | Combined Federal and State Income Tax (L44 + L51) | \$ 2,396 | | \$ 13,390 | |
| 53 | Applicable Federal Income Tax Rate [Col. [E], L51 - Col. [B], L51] / [Col. [E], L45 - Col. [B], L45] | | | | 16.6197% |
| <u>Calculation of Interest Synchronization:</u> | | | | | |
| 54 | Rate Base | \$ 752,586 | | | |
| 55 | Weighted Average Cost of Debt | 1.7000% | | | |
| 56 | Synchronized Interest (L45 X L46) | \$ 12,794 | | | |

RATE BASE - ORIGINAL COST

| LINE NO. | (A) COMPANY AS FILED | (B) STAFF ADJUSTMENTS | Adj. No. | (C) STAFF AS ADJUSTED |
|--------------|---|--------------------------|-------------------|--------------------------|
| 1 | Plant in Service | \$ 1,555,530 | \$ 250,000 | \$ 1,805,530 |
| 2 | Less: Accumulated Depreciation | 658,177 | - | 658,177 |
| 3 | Net Plant in Service | <u>\$ 897,353</u> | <u>\$ 250,000</u> | <u>\$ 1,147,353</u> |
| <u>LESS:</u> | | | | |
| 4 | Contributions in Aid of Construction (CIAC) | \$ 978,305 | \$ - | \$ 978,305 |
| 5 | Less: Accumulated Amortization | 502,287 | 81,250 | 583,537 |
| 6 | Net CIAC | <u>476,018</u> | <u>(81,250)</u> | <u>\$ 394,768</u> |
| 7 | Advances in Aid of Construction (AIAC) | - | - | - |
| 8 | Customer Deposits | - | - | - |
| 9 | Deferred Income Tax Credits | - | - | - |
| <u>ADD:</u> | | | | |
| 9 | Deferred Regulatory Assets | - | - | - |
| 10 | Cash Working Capital | - | - | - |
| 11 | Prepayments | - | - | - |
| 12 | Original Cost Rate Base | <u>\$ 421,336</u> | <u>\$ 331,250</u> | <u>\$ 752,586</u> |

References:

Column (A), Company Schedule B-1
Column (B): Schedule CSB-4

SUMMARY OF ORIGINAL COST RATE BASE ADJUSTMENTS

| LINE NO. | ACCT. NO. | | [A] | [B] | [H] | [C] |
|--------------------------|-----------|---|------------------|----------------------------|--------------------------|----------------|
| <u>PLANT IN SERVICE:</u> | | DESCRIPTION | COMPANY AS FILED | Treatment & Disposal Plant | Accumulated Depreciation | STAFF ADJUSTED |
| 2 | 351 | Organization | \$ 30,909 | \$ - | \$ - | \$ 30,909 |
| 3 | 352 | Franchises | - | - | - | - |
| 4 | 353 | Land and Land Rights | 45,400 | - | - | 45,400 |
| 5 | 354 | Structures and Improvements | 108,242 | - | - | 108,242 |
| 6 | 355 | Power Generation Equipment | - | - | - | - |
| 7 | 360 | Collection Services - Force | 328,735 | - | - | 328,735 |
| 8 | 361 | Collection Services - Gravity | - | - | - | - |
| 9 | 362 | Special Collecting Structures | - | - | - | - |
| 10 | 363 | Services to Customers | 73,179 | - | - | 73,179 |
| 11 | 364 | Flow Measuring Devices | 12,958 | - | - | 12,958 |
| 12 | 365 | Flow Measuring Installations | - | - | - | - |
| 13 | 370 | Receiving Wells | - | - | - | - |
| 14 | 371 | Effluent Pumping Equipment | - | - | - | - |
| 15 | 380 | Treatment and Disposal Equipment | 865,491 | 250,000 | - | 1,115,491 |
| 16 | 381 | Plant Sewers | - | - | - | - |
| 17 | 382 | Outfall Sewer Lines | - | - | - | - |
| 18 | 389 | Other Plant & Misc. Equipment | - | - | - | - |
| 19 | 390 | Office Furniture & Equipment | 5,803 | - | - | 5,803 |
| 20 | 391 | Transportation Equipment | - | - | - | - |
| 21 | 393 | Tools, Shop & Garage Equipment | 4,676 | - | - | 4,676 |
| 22 | 394 | Labratory Equipment | 630 | - | - | 630 |
| 23 | 395 | Power Operated Equipment | - | - | - | - |
| 24 | 396 | Communication Equipment | - | - | - | - |
| 25 | 398 | Other Tangible Plant | 79,507 | - | - | 79,507 |
| 26 | | | - | - | - | - |
| 27 | | | | | | |
| 28 | | Total Plant in Service | \$ 1,555,530 | \$ 250,000 | \$ - | \$ 1,805,530 |
| 29 | | Less: Accumulated Depreciation | 658,177 | - | - | 658,177 |
| 30 | | | - | - | - | - |
| 31 | | Net Plant in Service (L59 - L 60) | \$ 897,353 | \$ 250,000 | \$ - | \$ 1,147,353 |
| 32 | | | | | | |
| 33 | | <u>LESS:</u> | | | | |
| 34 | | Contributions in Aid of Construction (CIAC) | \$ 978,305 | \$ - | \$ - | \$ 978,305 |
| 35 | | Less: Accumulated Amortization | 502,287 | - | 81,250 | 583,537 |
| 36 | | Net CIAC (L25 - L26) | 476,018 | - | (81,250) | 394,768 |
| 37 | | Advances in Aid of Construction (AIAC) | - | - | - | - |
| 38 | | Customer Deposits | - | - | - | - |
| 39 | | Deferred Income Taxes | - | - | - | - |
| 40 | | | - | - | - | - |
| 41 | | | | | | |
| 42 | | <u>ADD:</u> | | | | |
| 43 | | Deferred Reg Asset | - | - | - | - |
| 44 | | Cash Working Capital | - | - | - | - |
| 45 | | Prepayments | - | - | - | - |
| 46 | | Original Cost Rate Base | \$ 421,336 | \$ 250,000 | \$ 81,250 | \$ 752,586 |

Calculation of Accumulated Depreciation
\$ 250,000
x 0.05 Acct No. 380 Depr Rate
\$ 12,500
6.5 Yrs (See Note 1)
\$ 81,250

Note 1: The \$250,000 equipment lease was in its 7th year at the end of the test year. Staff calculated depreciation expense using the half-year convention.

OPERATING INCOME STATEMENT - ADJUSTED TEST YEAR AND STAFF RECOMMENDED

| LINE NO. | DESCRIPTION | [A] COMPANY ADJUSTED TEST YEAR AS FILED | [B] STAFF TEST YEAR ADJUSTMENTS | Adj. No. | [C] STAFF TEST YEAR AS ADJUSTED | [D] STAFF PROPOSED CHANGES | [E] STAFF RECOMMENDED |
|----------|---------------------------------------|---|--|-------------|---|-------------------------------------|-----------------------------|
| 1 | <u>REVENUES:</u> | | | | | | |
| 2 | Flat Rate Revenues | \$ 462,400 | \$ - | | \$ 462,400 | \$ 50,589 | \$ 512,989 |
| 3 | Unmetered Revenues | 7,527 | - | | 7,527 | - | 7,527 |
| 4 | Other Wastewater Revenues | 9,624 | - | | 9,624 | - | 9,624 |
| 6 | Total Operating Revenues | \$ 479,551 | \$ - | | \$ 479,551 | \$ 50,589 | \$ 530,140 |
| 7 | | | | | | | |
| 8 | <u>OPERATING EXPENSES:</u> | | | | | | |
| 9 | Salaries and Wages | \$ 31,683 | \$ (18,529) | 1 | \$ 13,154 | \$ - | \$ 13,154 |
| 10 | Purchased Wastewater Trmnt | - | - | | - | - | - |
| 11 | Sludge Removal Expense | 21,328 | 12,079 | 2 | 33,407 | - | 33,407 |
| 12 | Purchased Power | 36,970 | - | | 36,970 | - | 36,970 |
| 13 | Fuel for Power Production | - | - | | - | - | - |
| 14 | Chemicals | 13,584 | - | | 13,584 | - | 13,584 |
| 15 | Materials & Supplies | 5,772 | - | | 5,772 | - | 5,772 |
| 16 | Contractual Services, Accounting | - | - | | - | - | - |
| 17 | Contractual Services, Professional | 5,130 | - | | 5,130 | - | 5,130 |
| 18 | Contractual Services, Maintenance | - | - | | - | - | - |
| 19 | Contractual Services - Other | 227,098 | - | | 227,098 | - | 227,098 |
| 20 | Water Testing | 9,784 | - | | 9,784 | - | 9,784 |
| 21 | Rents | 31,055 | (31,055) | 3 | - | - | - |
| 22 | Transportation Expenses | 4,103 | - | | 4,103 | - | 4,103 |
| 23 | Insurance - General Liability | 5,108 | - | | 5,108 | - | 5,108 |
| 24 | Insurance - Health and Life | - | - | | - | - | - |
| 25 | Reg Comm Expense - Other | 2,355 | - | | 2,355 | - | 2,355 |
| 26 | Reg Comm Expense - Rate Case | 25,000 | - | | 25,000 | - | 25,000 |
| 27 | Miscellaneous Expense | 22,364 | - | | 22,364 | - | 22,364 |
| 28 | Bad Debt Expense | - | - | | - | - | - |
| 29 | Depreciation and Amortization Expense | 22,039 | 9,101 | 6 | 31,140 | - | 31,140 |
| 30 | Taxes other than Income | - | - | | - | - | - |
| 31 | Property Taxes | 21,173 | (1,059) | 4 | 20,114 | 707 | 20,822 |
| 32 | Income Taxes | (1,045) | 3,441 | 5 | 2,396 | 10,994 | 13,390 |
| 33 | Rounding | - | - | | - | - | - |
| 34 | Total Operating Expenses | \$ 483,501 | \$ (26,022) | | \$ 457,479 | \$ 11,701 | \$ 469,180 |
| 35 | Operating Income (Loss) | \$ (3,950) | \$ 26,022 | | \$ 22,072 | \$ 38,888 | \$ 60,959 |

References:

- Column (A): Company Schedule C-1
- Column (B): Schedule MEM-13
- Column (C): Column (A) + Column (B)
- Column (D): Schedules MEM-1 and MEM-2
- Column (E): Column (C) + Column (D)

SUMMARY OF OPERATING INCOME STATEMENT ADJUSTMENTS - TEST YEAR

| LINE NO. | DESCRIPTION | [A] COMPANY AS FILED | [B] Salaries and Wages, Directors ADJ #1 | [C] Sludge Removal Expense ADJ #2 | [D] Rents Expense Verde Santa Fe Expansion ADJ #3 | [E] Property Tax Expense ADJ #4 | [F] Income Tax Expense ADJ #5 | [G] Depreciation Expense ADJ #6 | [H] STAFF |
|----------|---------------------------------------|-------------------------|---|--------------------------------------|--|------------------------------------|----------------------------------|------------------------------------|-------------------|
| | | Ref. Sch CSB-7 | Ref. Sch CSB-7 | Ref. Sch CSB-8 | Ref. Sch CSB-9 | Ref. Sch CSB-10 | Ref. Sch CSB-11 | Ref. Sch CSB-12 | ADJUSTED |
| 1 | <u>REVENUES:</u> | | | | | | | | |
| 2 | Flat Rate Revenues | \$ 462,400 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 462,400 |
| 3 | Unmetered Revenues | 7,527 | - | - | - | - | - | - | 7,527 |
| 4 | Other Wastewater Revenues | 9,624 | - | - | - | - | - | - | 9,624 |
| 5 | Total Operating Revenues | \$ 479,551 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 479,551 |
| 6 | <u>OPERATING EXPENSES:</u> | | | | | | | | |
| 7 | Salaries and Wages | \$ 31,683 | (18,529) | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 13,154 |
| 8 | Purchased Wastewater Trmnt | - | - | - | - | - | - | - | - |
| 9 | Sludge Removal Expense | 21,328 | - | 12,079 | - | - | - | - | 33,407 |
| 10 | Purchased Power | 36,970 | - | - | - | - | - | - | 36,970 |
| 11 | Fuel for Power Production | - | - | - | - | - | - | - | - |
| 12 | Chemicals | 13,584 | - | - | - | - | - | - | 13,584 |
| 13 | Materials & Supplies | 5,772 | - | - | - | - | - | - | 5,772 |
| 14 | Contractual Services, Accounting | - | - | - | - | - | - | - | - |
| 15 | Contractual Services, Professional | 5,130 | - | - | - | - | - | - | 5,130 |
| 16 | Contractual Services, Maintenance | - | - | - | - | - | - | - | - |
| 17 | Contractual Services - Other | 227,098 | - | - | - | - | - | - | 227,098 |
| 18 | Water Testing | 9,784 | - | - | - | - | - | - | 9,784 |
| 19 | Rents | 31,055 | - | - | (31,055) | - | - | - | - |
| 20 | Transportation Expenses | 4,103 | - | - | - | - | - | - | 4,103 |
| 21 | Insurance - General Liability | 5,108 | - | - | - | - | - | - | 5,108 |
| 22 | Insurance - Health and Life | - | - | - | - | - | - | - | - |
| 23 | Reg Comm Expense - Other | 2,355 | - | - | - | - | - | - | 2,355 |
| 24 | Reg Comm Expense - Rate Case | 25,000 | - | - | - | - | - | - | 25,000 |
| 25 | Miscellaneous Expense | 22,364 | - | - | - | - | - | - | 22,364 |
| 26 | Bad Debt Expense | - | - | - | - | - | - | - | - |
| 27 | Depreciation and Amortization Expense | 22,039 | - | - | - | - | 9,101 | - | 31,140 |
| 28 | Taxes other than Income | 21,173 | - | - | - | (1,059) | - | - | 20,114 |
| 29 | Property Taxes | (1,045) | - | - | - | - | 3,441 | - | 2,396 |
| 30 | Income Taxes | - | - | - | - | - | - | - | - |
| 31 | Total Operating Expenses | \$ 483,501 | (18,529) | \$ 12,079 | (31,055) | (1,059) | \$ 3,441 | \$ 9,101 | \$ 448,378 |
| 32 | Operating Income (Loss) | \$ (3,950) | \$ 18,529 | (12,079) | \$ 31,055 | \$ 1,059 | (3,441) | (9,101) | \$ 31,173 |

OPERATING INCOME ADJUSTMENT NO. 1 - SALARIES & WAGES, DIRECTORS

| LINE NO. | DESCRIPTION | [A] | [B] | [C] |
|----------|-----------------------------|------------------|-------------------|-------------------|
| | | COMPANY AS FILED | STAFF ADJUSTMENTS | STAFF AS ADJUSTED |
| 1 | Salaries & Wages, Directors | \$ 31,683 | \$ (18,529) | \$ 13,154 |
| 2 | | | | |
| 3 | | | | |
| 4 | | | | |
| 5 | | | | |
| 6 | | | | |

| [D] | [E] | [F] | [G] |
|------------|--|--------------------------------------|---|
| Employee | Total Hours Worked per Month for All Directors | Number of Months Each Director Works | Total Annual Hours Worked for Each Director |
| Director 1 | 8 x | 12 = | 96 |
| Director 2 | 8 x | 12 = | 96 |
| Director 3 | 8 x | 12 = | 96 |
| | 24 | 36 | \$ 288 |
| | | Multiplied by | \$ 46 From Line 20 |
| | Salaries & Wages, Directors - Per Staff | | \$ 13,154 |
| | | Director Salary | \$ 95,000 |
| | | Divided by Annual Work Hours | 2,080 |
| | | Hourly Rate | \$ 45.67 |

References:

- Column A: Company Schedule C-1
- Column B: Testimony, CSB,
- Column C: Column [A] + Column [B]

Verde Santa Fe Wastewater Company, Inc.
Docket No. SW-03437A-13-0292
Test Year Ended December 31, 2012

Hearing Surrebuttal Schedule CSB-8

OPERATING INCOME ADJUSTMENT NO. 2 - SLUDGE REMOVAL EXPENSE

| LINE NO. | | [A] | [B] | [C] |
|-------------|------------------------|---------------------|----------------------|----------------------|
| | | COMPANY AS FILED | STAFF ADJUSTMENTS | STAFF AS ADJUSTED |
| 1 | Sludge Removal Expense | \$ 21,328 | \$ 12,079 | \$ 33,407 |

References:

- Column A: Company Schedule C-1
- Column B: Testimony, CSB,
- Column C: Column [A] + Column [B]

Verde Santa Fe Wastewater Company, Inc.
Docket No. SW-03437A-13-0292
Test Year Ended December 31, 2012

Hearing Surrebuttal Schedule CSB-9

OPERATING INCOME ADJUSTMENT NO. 3 - RENTS EXPENSE, VERDE SANTA FE EXPANSION

| LINE NO. | | [A] | [B] | [C] |
|----------|---|------------------|-------------------|-------------------|
| | | COMPANY AS FILED | STAFF ADJUSTMENTS | STAFF AS ADJUSTED |
| 1 | Rents Expense, Verde Santa Fe Expansion | \$ 31,055 | \$ (31,055) | \$ - |

References:

- Column A: Company Schedule C-1
- Column B: Testimony, CSB,
- Column C: Column [A] + Column [B]

OPERATING INCOME ADJUSTMENT No. 4 - Property Tax Expense

| LINE NO. | Property Tax Calculation | STAFF AS ADJUSTED | STAFF RECOMMENDED |
|----------|--|-------------------|-------------------|
| 1 | Staff Adjusted Test Year Revenues | \$ 479,551 | \$ 479,551 |
| 2 | Weight Factor | <u>2</u> | <u>2</u> |
| 3 | Subtotal (Line 1 * Line 2) | 959,102 | \$ 959,102 |
| 4 | Staff Recommended Revenue, Per Schedule CSB-1 | 479,551 | \$ 530,140 |
| 5 | Subtotal (Line 4 + Line 5) | 1,438,653 | 1,489,242 |
| 6 | Number of Years | 3 | 3 |
| 7 | Three Year Average (Line 5 / Line 6) | 479,551 | \$ 496,414 |
| 8 | Department of Revenue Mutilplier | 2 | 2 |
| 9 | Revenue Base Value (Line 7 * Line 8) | 959,102 | \$ 992,828 |
| 10 | Plus: 10% of CWIP - | - | - |
| 11 | Less: Net Book Value of Licensed Vehicles | - | \$ - |
| 12 | Full Cash Value (Line 9 + Line 10 - Line 11) | 959,102 | \$ 992,828 |
| 13 | Assessment Ratio | 19.0% | 19.0% |
| 14 | Assessment Value (Line 12 * Line 13) | 182,229 | \$ 188,637 |
| 15 | Composite Property Tax Rate (Per Company Schedule C-2) | <u>11.0379%</u> | <u>11.0379%</u> |
| 16 | Staff Test Year Adjusted Property Tax (Line 14 * Line 15) | \$ 20,114 | \$ - |
| 17 | Company Proposed Property Tax | <u>21,173</u> | |
| 18 | Staff Test Year Adjustment (Line 16-Line 17) | <u>\$ (1,059)</u> | |
| 19 | Property Tax - Staff Recommended Revenue (Line 14 * Line 15) | | \$ 20,822 |
| 20 | Staff Test Year Adjusted Property Tax Expense (Line 16) | | \$ 20,114 |
| 21 | Increase in Property Tax Expense Due to Increase in Revenue Requirement | | <u>\$ 707</u> |
| 22 | Increase to Property Tax Expense | | \$ 707 |
| 23 | Increase in Revenue Requirement | | 50,589 |
| 24 | Increase to Property Tax per Dollar Increase in Revenue (Line19/Line 20) | | 1.398134% |

OPERATING INCOME ADJUSTMENT NO. 5 - TEST YEAR INCOME TAXES

LINE
NO.

DESCRIPTION

| | <u>Test Year</u> |
|---|-------------------------------------|
| <i>Calculation of Income Tax:</i> | |
| 1 Revenue (Schedule CSB-11) | \$ 479,551 |
| 2 Operating Expenses Excluding Income Taxes | \$ 455,083 |
| 3 Synchronized Interest (L17) | \$ 12,794 |
| 4 Arizona Taxable Income (L1 - L2 - L3) | \$ 11,674 |
| 5 Arizona State Income Tax Rate | 6.5000% |
| 6 Arizona Income Tax (L4 x L5) | \$ 759 |
| 7 Federal Taxable Income (L4 - L6) | \$ 10,915 |
| 8 Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15% | \$ 1,637 |
| 9 Federal Tax on Second Income Bracket (\$51,001 - \$75,000) @ 25% | \$ - |
| 10 Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34% | \$ - |
| 11 Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39% | \$ - |
| 12 Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34% | \$ - |
| 13 Total Federal Income Tax | \$ 1,637 |
| 14 Combined Federal and State Income Tax (L44 + L51) | <u>\$ 2,396</u> |
| <i>Calculation of Interest Synchronization:</i> | |
| 15 Rate Base (Schedule CSB-13, Col. (C), Line 16) | \$ 752,586 |
| 16 Weighted Average Cost of Debt | 1.70% |
| 17 Synchronized Interest (L16 x L17) | <u>\$ 12,794</u> |
| 18 | Income Tax - Per Staff \$ 2,396 |
| 19 | Income Tax - Per Company \$ (1,045) |
| 20 | Staff Adjustment \$ 3,441 |

Operating Income Adjustment No. 6 - Depreciation Expense

LINE ACCT.
NO. NO.

PLANT IN SERVICE:

| | | | [A] | [B] | [C] | [D] | [E] |
|------------------------|-----|----------------------------------|----------------------------|--|-----------------------------------|-------------------|--------------------------------------|
| | | DESCRIPTION | Plant In Service Per Staff | NonDepreciable & Fully Depreciated Plant | Depreciable Plant (Col A - Col B) | Depreciation Rate | Depreciation Expense (Col C x Col D) |
| 1 | | | | | | | |
| 2 | 351 | Organization | \$ 30,909 | \$ (30,909) | \$ - | 0.00% | \$ - |
| 3 | 352 | Franchises | - | - | - | 0.00% | - |
| 4 | 353 | Land and Land Rights | 45,400 | - | 45,400 | 0.00% | - |
| 5 | 354 | Structures and Improvements | 108,242 | - | 108,242 | 3.33% | 3,604 |
| 6 | 355 | Power Generation Equipment | - | - | - | 5.00% | - |
| 7 | 360 | Collection Services - Force | 328,735 | - | 328,735 | 2.00% | 6,575 |
| 8 | 361 | Collection Services - Gravity | - | - | - | 2.00% | - |
| 9 | 362 | Special Collecting Structures | - | - | - | 2.00% | - |
| 10 | 363 | Services to Customers | 73,179 | - | 73,179 | 2.00% | 1,464 |
| 11 | 364 | Flow Measuring Devices | 12,958 | - | 12,958 | 10.00% | 1,296 |
| 12 | 365 | Flow Measuring Installations | - | - | - | 10.00% | - |
| 13 | 370 | Receiving Wells | - | - | - | 3.33% | - |
| 14 | 371 | Effluent Pumping Equipment | - | - | - | 12.50% | - |
| 15 | 380 | Treatment and Disposal Equipment | 1,115,491 | - | 1,115,491 | 5.00% | 55,775 |
| 16 | 381 | Plant Sewers | - | - | - | 5.00% | - |
| 17 | 382 | Outfall Sewer Lines | - | - | - | 3.33% | - |
| 18 | 389 | Other Plant & Misc. Equipment | - | - | - | 6.67% | - |
| 19 | 390 | Office Furniture & Equipment | 5,803 | - | 5,803 | 6.67% | 387 |
| 20 | 391 | Transportation Equipment | - | - | - | 20.00% | - |
| 21 | 393 | Tools, Shop & Garage Equipment | 4,676 | - | 4,676 | 5.00% | 234 |
| 22 | 394 | Labratory Equipment | 630 | - | 630 | 10.00% | 63 |
| 23 | 395 | Power Operated Equipment | - | - | - | 5.00% | - |
| 24 | 396 | Communication Equipment | - | - | - | 10.00% | - |
| 25 | 398 | Other Tangible Plant | 79,507 | - | 79,507 | - | - |
| 26 | | | - | - | - | - | - |
| Total Plant in Service | | | \$ 1,805,530 | \$ (30,909) | \$ 1,774,621 | | \$ 69,397 |

| | |
|---|-----------------|
| Composite Depreciation Rate (Depr Exp / Depreciable Plant): | 3.91% |
| Gross CIAC: | \$ 978,305 |
| Amortization of CIAC (Line 28 x Line 29): | \$ 38,257 |
| Depreciation Expense Before Amortization of CIAC: | \$ 69,397 |
| Less Amortization of CIAC: | \$ 38,257 |
| Test Year Depreciation Expense - Staff: | \$ 31,140 |
| Depreciation Expense - Company: | 22,039 |
| Staff's Total Adjustment: | \$ 9,101 |

Exhibit 2
Revised Capital Structure

Verde Santa Fe Wastewater Company Cost of Capital Calculation
 Capital Structure
 And Weighted Average Cost of Capital

Restated as per Administrative Law Judge Request

[A]

[B]

[C]

[D]

| <u>Description</u> | <u>Weight (%)</u> | <u>Cost</u> | <u>Weighted Cost</u> |
|----------------------------------|-------------------|-------------|----------------------|
| Debt | 33.8% | 5.0% | 1.7% |
| Common Equity | 66.2% | 9.6% | 6.4% |
| Weighted Average Cost of Capital | | | 8.1% |