BEFORE THE ARIZONA CORPORATION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF LAGO DEL ORO WATER 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-01944A-13-0215

DECISION NO. 74564

OPINION AND ORDER

DATE OF HEARING:	April 3, 2014
PLACE OF HEARING:	Tucson, Arizona
ADMINISTRATIVE LAW JUDGE:	Jane L. Rodda
APPEARANCES:	Jay Shapiro, FENNEMORE CRAIG, PC, on behalf of Lago del Oro Water Company; and Brian E. Smith, Staff Attorney, Legal Division, on behalf of the Arizona Corporation Commission Utilities Division.

BY THE COMMISSION:

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Having considered the entire record herein and being fully advised in the premises, the Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

FINDINGS OF FACT

Procedural History

1. On June 27, 2013, Lago Del Oro Water Company ("LDO" or "Company") filed an application with the Commission for a rate increase ("Rate Application").

2. On July 10, 2013, LDO filed an Application with the Commission for authority to: (1) issue evidence of indebtedness in an amount not to exceed $3,900,000: and (2) encumber its real

property and utility plant as security for such indebtedness ("Finance Application").[1] In the Finance Application, the Company sought authority to issue long-term debt to reimburse shareholders for the purchase of assets being used to provide service. The Company asserted that by issuing debt it would have a more balanced capital structure which would benefit ratepayers in setting rates.

3. On July 24, 2013, LDO filed a revised Schedule H3 to its Rate Application regarding commodity rates.

4. On July 26, 2013, the Commission's Utilities Division ("Staff") notified LDO that its Rate Application was sufficient under the guidelines outlined in the Arizona Administrative Code ("A.A.C.") R14-2-103, and classified the Company as a Class B utility.

5. By Procedural Order dated August 6, 2013, the matter was set for hearing on April 3, 2014, and other procedural guidelines were established.

6. On December 20, 2013, LDO filed a Notice of Filing Certification of Publication and Proof of Mailing, indicating that notice of the hearing was published in the *Arizona Daily Star* on October 4, 2013 and in the *San Manuel Miner* on October 9, 2013; and was mailed to LDO's customers on September 30, 2013.

7. On January 17, 2014, Staff filed the Direct Testimony of Mary Rimback, Michael Thompson and John Cassidy.

8. On January 24, 2014, Staff filed the Direct Testimony of Ms. Rimback related to rate design and of Mr. Thompson related to cost of service.

9. On February 11, 2014, LDO filed an Unopposed Motion for Extension of Time to File Rebuttal Testimony, from February 14, 2014, to February 18, 2014. LDO's request was granted by Procedural Order dated February 12, 2014.

10. By Procedural Order dated February 26, 2014, Staff and the Company were directed to file comments on whether the Rate Application and Finance Application should be consolidated.

11. On February 18, 2014, LDO filed the Rebuttal Testimony of Ray Jones and Thomas Bourassa.

[1] Docket No. W-01944A-13-0242.

12. On March 7, 2014, LDO and Staff filed their positions on the merits of consolidation. LDO asserted that: (1) its request for financing would rebalance its capital structure from 100 percent equity to one including an amount of debt that more closely resembles the capital structures of the proxy companies used to determine cost of equity; (2) the new loan represents good business practice and is appropriate whether or not rates are increased; (3) completing the financing before the rate case would remove uncertainty in establishing the appropriate cost of debt; and (4) approving the financing sooner would reduce the risk of rising interest rates. Staff agreed with the Company's arguments and also responded that consolidation was not necessary since LDO would be able to service the proposed debt without a rate increase. In Decision No. 74450 (April 21, 2014), the Commission agreed with the parties' positions not to consolidate the matters, and authorized the Company to borrow up to $2,751,411, for a term of seven years, at an interest rate not to exceed 6 percent per year.

13. On March 10, 2014, Staff filed the Surrebuttal Testimony of Ms. Rimback, Mr. Cassidy and Mr. Thompson.

14. On March 21, 2014, LDO filed the Rejoinder Testimony of Mr. Jones and Mr. Bourassa.

15. On March 27, 2014, the parties, appearing through counsel, participated in a pre-hearing conference to schedule witnesses and address other matters related to the conduct of the hearing.

16. The hearing convened on April 3, 2014, before a duly authorized Administrative Law Judge. The Commission received nine written comments in opposition to the increase. No customers appeared at the hearing to make public comment.

17. On May 5, 2014, LDO and Staff filed post-hearing briefs. LDO also filed its Final Schedules and Notice of Late-Filed Exhibits which indicated the Company was in compliance with the requirements of the Arizona Department of Water Resources ("ADWR").

18. On May 19, 2014, LDO filed a Reply Brief, and Staff filed Notice that it would not file a Reply Brief.

Background

19. LDO is a for-profit "C" Corporation, and a Class "B" Arizona public service corporation, providing water utility service to customers in portions of Pima and Pinal Counties. In the test year ended December 31, 2012 ("test year"), LDO served approximately 6,348 connections in the unincorporated master planned community of SaddleBrooke, the unincorporated community of Catalina, and a smaller residential community surrounded by SaddleBrooke, known as Loma Serena.

20. LDO is an affiliate of Robson Communities, Inc. ("Robson"). Robson's other water and wastewater utility affiliates include: Ridgeview Utility Company, SaddleBrooke Utility Company (providing wastewater service to SaddleBrooke), Quail Creek Water Company, Inc., Picacho Water Company, Picacho Sewer Company, Pima Utility Company, Mountain Pass Utility Company, Santa Rosa Water Company, and Santa Rosa Utility Company.

21. Staff reported that as of August 27, 2013, the Commission's compliance database indicated that LDO had no delinquencies. A review of the Utilities Division's Consumer Service data base from 2011 through 2013, revealed that no complaints were filed in 2011 or 2012, and two complaints were filed in 2013. According to Staff, all complaints were resolved and closed.

22. LDO's current rates were approved in Decision No. 56464 (April 26, 1989), except that separate irrigation rates were established in Decision No. 57766 (March 16, 1992). LDO had 700 connections in the test year utilized in Decision No. 56464.

23. The LDO system includes two interconnected service areas: SaddleBrooke and Catalina. The SaddleBrooke service area consists of four water plant sites, seven wells, and a looped distribution system with six pressure zones. The Catalina service area consists of one water plant site, four well/storage and booster pump station sites, three independent booster pump stations, nine wells and a looped distribution system with three pressure zones. In Staff's opinion, the plant facilities were in proper working order, properly maintained, and in excellent condition.[2] Combined, the systems have a production capacity of 8,175 gallons per minute ("GPM") and a storage capacity of 1,834,000 gallons.[3] Staff concluded that LDO has adequate production and storage capacity to

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[2] Ex S-1-B Thompson Dir MT-1 at 5.
[3] Ex S-1-B Thompson Dir MT-1 at 14.

serve the current customer base and reasonable growth.[4]

24. According to the Arizona Department of Environmental Quality ("ADEQ") Compliance Status Report dated January 7, 2014, there are no major deficiencies in the operation, maintenance or certified operator status of the water system, and the LDO system is currently delivering water that meets water quality standards required by 40 CFR 141 (National Primary Drinking Water Regulations) and A.A.C. Title 18, Chapter 4.[5]

25. LDO's service area is located within ADWR's Tucson Active Management Area ("Tucson AMA"). At the time of Staff's direct testimony, ADWR reported that LDO had not filed its Water System Plan, and was consequently non-compliant with departmental requirements governing water providers and/or community water systems.[6] Staff recommended that any increase in rates approved by the Commission in this proceeding not become effective until ADWR determined that LDO is in compliance with its requirements governing water providers and/or community water systems.[7] Prior to filing its Rebuttal Testimony, the Company submitted its Water System Plan to ADWR and received approval.[8] In Surrebuttal Testimony, Staff noted LDO's compliance regarding the Water System Plan, but indicated that it had received information that LDO's Well No. 19 had not been properly permitted by ADWR.[9] Therefore, Staff retained its recommendation that the new rates not go into effect until LDO demonstrated compliance with ADWR requirements. After the hearing, LDO received a determination from ADWR that Well No. 19 is now properly permitted.[10] Given documentation provided by the Company, Staff finds that the compliance issue is resolved, and that there is no longer a need to recommend conditional approval of the new rates.[11]

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[4] Ex S-1-B Thompson Dir MT-1 at 14.

[5] Ex S-1-B Thompson Dir MT-1 at 16. The Engineering Report indicated that LDO was following ADEQ's Containment Sampling schedules, with the exception of Volatile Compounds ("VOC"), and Radiochemicals ("RAD"). As a result, Staff recommended that LDO revise its VOC and RAD sampling testing schedule to conform to ADEQs schedule. The Company responded that it was in compliance with all ADEQ schedules and accepted responsibility for confusing the point. Ex A-2 Jones Rebuttal at 5. Staff did not dispute the Company's rebuttal claims in Surrebuttal Testimony, at the hearing, or in its Closing Brief. Therefore, this issue is deemed resolved without the need for Commission action.

[6] Ex S-1-B Thompson Dir MT-1 at 18.

[7] Ex S-1-B Thompson Dir MT-1 at 2.

[8] Ex A-2 Jones Reb at 3.

[9] Ex S-3-C Thompson Surr at 2.

[10] Late-filed Ex A-11 and Ex A-12.

[11] Staff Opening Brief at 12.

26. LDO has approved Curtailment and Backflow Tariffs on file with the Commission.[12]

Rate Application

27. In the test year, the parties agree that LDO had total revenues of $1,882,238.[13]

28. According to the Company's Final Schedules, with total adjusted operating expenses of $1,936,561, the Company had an operating loss of $54,323 in the test year.[14]

29. LDO requests a revenue requirement of $2,958,093, an increase of $1,075,855, or 57.2 percent, over adjusted test year revenues. LDO proposes operating expenses totaling $2,354,241, resulting in Operating Income of $603,852, an 8.2 percent rate of return on a proposed Fair Value Rate Base ("FVRB") of $7,364,049.

30. Staff recommends a revenue increase of $1,029,215, or 54.68 percent, over test year revenue, for a total revenue requirement of $2,911,453, which based on Staff's recommended adjusted operating expenses of $2,307,403, results in Operating Income of $604,050, an 8.2 percent rate of return on a Staff-recommended FVRB of $7,366,456.[15]

31. The parties agreed on a capital structure consisting of 29 percent debt and 71 percent equity and a Weighted Average Cost of Capital ("WACC") of 8.2 percent, based on a cost of debt of 4.6 percent, and cost of equity of 9.7 percent.[16]

32. In the course of the proceeding, the parties resolved many issues. At the time of the hearing, issues in dispute included: rate base adjustments affecting depreciated plant balances, the amortized Contributions in Aid of Construction ("CIAC") balance, and Accumulated Deferred Income Taxes ("ADIT"); income statement issues involving Depreciation Expenses and audit costs; the cost of equity; the implementation of Best Management Practices ("BMP") tariffs; and conditional approval of the rates based on documenting ADWR compliance. Subsequent to the hearing, the parities resolved between themselves the disputed issues involving audit fees, cost of equity, rate of return and ADWR compliance.[17]

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[12] Ex S-1-B Thompson Dir MT-1 at 21.
[13] LDO Final Schedule A-1. Staff Opening Brief at 2.
[14] LDO Final Schedule C-1.
[15] Staff Opening Brief at 2.
[16] Staff Opening Brief at 2-3. LDO Initial Brief at 2.
[17] Staff Opening Brief at 3. LDO Reply Brief at 1.

Rate Base

33. The Company proposes an adjusted test year Original Cost Rate Base ("OCRB") of $7,364,049.[18] Staff recommends an adjusted OCRB of $7,366,456. LDO and Staff agree that the Company's OCRB should be deemed to be its FVRB.[19]

34. The difference in the rate bases proposed by LDO and Staff is a result of using different depreciation methodologies to reconstruct the plant values since the last rate case, and a disagreement over the computation of ADIT arising from bonus depreciation that the Company claimed on its 2012 tax return.

Depreciation Methodology

35. LDO's current rates became effective on or about May 1, 1989, at which time the Company served approximately 700 connections. Between the last rate case and the current test year, LDO added a substantial amount of plant to serve its growing customer base. The new plant was constructed and initially funded by LDO's affiliated company, SaddleBrooke Development Company ("SDC") at various times between 1997 and 2009.[20] In 2012, LDO purchased from SDC a significant portion of the plant at its original cost of $3,887,998.[21]

36. The Company reported the acquired plant in its Rate Application at its original cost and purchase price of $3,887,998.[22] Staff concluded that the costs associated with the installation of the plant infrastructure and backbone plant were reasonable.[23] Staff, however, did not find that it is appropriate to add plant to rate base that has been in use to provide service to LDO's customers for several years at its original cost. Staff adjusted the original plant cost values to reflect the level of accumulated depreciation that would have been incurred from the time that the plant was placed in service assuming a 5 percent deprecation rate.[24] In rebuttal, the Company agreed with Staff that rate

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[18] LDO Final Schedule at B-1.
[19] Ex A-5 Bourassa Dir at 6.
[20] Staff Initial Brief at 3-4, *citing* Ex S-1-A Rimback Dir; Ex S-3-A Rimback Surr at 4, Ex S-1-B Thompson Dir MT-1 at Section J.
[21] Ex S-1-A Rimback Dir at 4. It is Company practice to acquire plant as soon as it has funds available; in this case, LDO did not have sufficient cash flow to acquire the constructed plant from SDC until shareholders made a capital contribution in 2012. Hearing Transcript ("Tr.") at 54.
[22] Ex A-5 Bourassa Surr Schedules.
[23] Ex S-A-B Thompson Dir MT-1 at 23.
[24] Staff Initial Brief at 4. The last rate case approved the 5 percent depreciation rate for all depreciable assets.

base should not be increased by the full original cost of the plant, but argued that the appropriate method of accounting for the acquired plant was to book the plant at its original cost and to reflect the depreciation of the plant in the Accumulated Depreciation Account.[25] The parties eventually agreed that recording both the original cost and accumulated depreciation is the appropriate way to book the plant that had been in service for several years.[26]

37. The Company proposes Plant in Service of $18,200,198, and Accumulated Depreciation of $9,977,386, for Net Utility Pant in Service of $8,222,812.[27] Staff recommends Plant in Service of $18,200,199 and Accumulated Depreciation of $9,606,122, for Net Plant in Service of $8,594,077.[28] The difference in Net Plant in Service of $371,265 results from the Company's use of the Broad Group method of accounting for depreciation and Staff's use of the Vintage Year method of calculating depreciation. The different depreciation methodologies also result in Staff's recommended increase in net CIAC of $87,724 and an annual reduction of $40,587 to Depreciation Expense.[29]

38. The Company asserts that there is nothing wrong or unusual about its use of the Broad Group Method to depreciate its plant,[30] and that the Broad Group method is recognized as acceptable under National Association of Regulatory Commissioners ("NARUC") practices.[31] Under the Broad Group Method, assets are grouped based on NARUC plant account and the entire group is tracked and depreciated.[32] Under this methodology, individual plant assets are not tracked for depreciation.

39. Staff employed the Vintage Year depreciation methodology. Under this method, Staff stopped recording depreciation on plant that had been in service for over 20 years.[33] Staff argues that the most notable problem with the Broad Group method is that it allows individual plant assets to be depreciated beyond their original cost, and thus, does not comply with A.A.C. R14-2-102(3), which

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[25] Ex A-7 Bourassa Reb at 4-5.
[26] Ex S-3-A Rimback Surr at 5.
[27] LDO Final Schedule at B-1.
[28] Ex S-3-A Rimback Surr Schedule MJR-W3.
[29] *Compare* LDO Final Schedule at Ex B-2 an Ex-S-3-A Rimback Surr Schedules MJR-3. *See* Ex S-1-A Rimback Dir at 12.
[30] LDO Initial Brief at 4.
[31] Ex S-7 Bourassa Reb at 10.
[32] Tr. at 197-198.
[33] Ex S-1-A Rimback Dir at 11. Because the last rate case approved a 5 percent depreciation rate, all plant items would be fully depreciated after 20 years.

defines "Depreciation" as an accounting process which will permit the recovery of the original cost of an asset less its net salvage over the service life. Staff argues the Broad Group method allows for the over-recovery of an asset's cost by allowing it to be depreciated beyond its original cost. Staff argues that the Commission's determination to require the Vintage Year method in the New River Utility Company rate case supports its position in this case.[34]

40. The Company argues that Staff has introduced additional complexity and confusion into the depreciation accounting without any corresponding benefit.[35] The Company dismisses Staff's concern that the Company was not retiring fully depreciated plant, and claims that Staff could not identify a single item of fully depreciated plant that the Company was trying to include in rate base.[36] The Company does not claim that there can never be fully depreciated plant under the Broad Group method, but that for this Company, at this time, there are no fully depreciated plant groups.[37] In addition, the Company asserts that when Staff applied its Vintage Year procedure, it created stranded negative accumulated depreciation amounts that are not being amortized.[38] The Company asserts that the failure to amortize and recover these negative accumulated depreciation amounts, understates Staff's accumulated depreciation balance, and that these plant balances become permanent rate base under Staff's approach.[39]

41. Ultimately, the Company states that the revenue requirement is only minimally affected by using Staff's Vintage Year method, because the reduction in Depreciation Expense of $41,000 and the impact of the higher rate base of $35,000 result in a net revenue impact of only $6,000. However, the Company argues that the drawback of Staff's adjustments which results in stranded negative accumulated depreciation balances warrants rejecting Staff's proposed rate base adjustments.[40]

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[34] Staff Opening Brief at 6-7. *See* Decision No. 74294 (January 27, 2014).
[35] LDO Initial Brief at 4.
[36] LDO Initial Brief at 5, Tr. at 181-187.
[37] Tr. at 67.
[38] Ex A-7 Bourassa Reb at 11. The Company identified total negative accumulated depreciation balances of $49,820 that would be created by adopting Staff's position. Tr. at 78.
[39] LDO Initial Brief at 5; Ex A-9 Bourassa RJ at 5-6.
[40] LDO Initial Brief at 6.

42. The Company expressed concern about the effect Staff's recommendation would have on LDO's efficient management, as it is one of several affiliated utilities with common ownership and control, all of which employ the Broad Group method.[41] The Company also argues that if Staff is advocating that all utilities employ the Vintage Year method, that this is not the appropriate case to make such policy determination, and that workshops or other generic proceeding involving all stakeholders would be more appropriate.[42]

43. There is no dispute over depreciation rates in this proceeding, nor is there a dispute that LDO did not remove retired assets from the books. Both the Broad Group and Vintage Year methodologies are recognized means of depreciating plant and acceptable under NARUC practices. Under the Broad Group method, plant remains on the books until it is removed from service, but an individual plant item is not removed from the group when it reaches its full economic service life. Thus, if an individual plant asset with an assumed twenty-year service life remains in service longer than twenty years, it remains on the books and continues to be depreciated as part of the group. The premise of this method is that some assets will last shorter than their expected life, some will last exactly the same as their expected life, and some will last longer, but on average, assets remain in service for the assumed term of their economic lives. An advantage of the Broad Group method is simplicity of accounting and a smoothing effect on fluctuations in depreciation expense.

44. In this case, LDO has some plant in service that has exceeded its service life. Staff considers these individual plant assets to be fully depreciated. However, under the Broad Group process, as long as the original cost of the group as a whole exceeds the accumulated depreciation on the group, it is not considered fully depreciated. Part of the reason the issue of methodologies has arisen in this case may be attributable to the 5 percent across-the-board depreciation rate approved in the last rate case. The 5 percent rate assumes an economic life of 20 years, which may not be a good estimate for some utility assets. The more accurate deprecation rates that the Commission now typically uses, and which LDO will use on a going-forward basis, may help alleviate the appearance of over-depreciating in the future.[43]

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[41] LDO Reply Brief at 3.
[42] LDO Reply Brief at 3-4.
[43] See Ex S-1-B Thompson Dir MT-1 at 19.

45. One of the complications of switching to the Vintage Year method is the creation of negative accumulated depreciation balances when depreciation is stopped on the assets that have reached their estimated service lives. These "stranded" amounts reduce total accumulated depreciation, and thus have the potential effect of permanently increasing rate base (because accumulated depreciation is a reduction to rate base). There are ways to amortize these stranded negative accumulated depreciation balances, but no solution was offered in this proceeding. Based on the evidence presented, we find that requiring LDO to adopt the Vintage Year method is not warranted. To do so would add a level of complexity that is not necessary. The Commission required New River Utility Company to adopt the Vintage Year method because the Commission had significant concerns about New River Utility's lack of precision in recordkeeping.[44] In this case, the recordkeeping concerns raised in the New River Utility case are not present.[45]

<u>CIAC</u>

46. The Company proposed a CIAC balance of $852,693 and Accumulated Amortization of $469,879, for a net CIAC of $382,814. Staff reduced CIAC by $99,159 to $753,534 and reduced Amortization of CIAC by $186,882, to $282,997, resulting in net CIAC of $470,537.[46] The $87,724 difference in net CIAC means that Staff's recommended rate base is $87,724 lower than the Company's as a result of the adjustment. Staff states that the CIAC balances from the last rate case were fully amortized by 1995, and asserts that in the Rate Application, the Company continued to amortize this fully amortized CIAC.[47] Staff states that its position regarding using Vintage Year depreciation does not impact the CIAC balance.[48] Staff further argues that the Company did not dispute Staff's CIAC adjustment at hearing.[49]

47. The Company asserts that the difference in the CIAC balances is the result of Staff's use of the Vintage Year method of depreciation. The Company states that it used the Broad Group

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[44] Decision No. 74294 at 18.

[45] Pima Utility Company is an affiliate of Robson and also utilizes the Broad Group method. Ex A-7 Bourassa Reb at 13. In the 2012 Pima Utility rate case, the Commission did not discuss the issue of Vintage Year depreciation. *See* Decision No. 73573 (November 21, 2012). LDO Reply Brief at 3.

[46] Ex S-3-A Rimback Surr at MJR-7.

[47] Ex S-3-A Rimback Surr at 8.

[48] Staff Opening Brief at 8.

[49] Staff Opening Brief at 8.

procedure for CIAC and Amortization of CIAC and that there is no unamortized CIAC using the Broad Group method.[50]

48. Staff does not assert that LDO is not properly accounting for retired plant, and the evidence shows that the Company's plant records are reliable. The issue affecting the CIAC balance appears to be the same as affecting the Utility Plant in Service balances. Because we allow the Company to continue to utilize the Broad Group method, we accept its position on the CIAC balances.

ADIT

49. In its Rate Application, the Company proposed an ADIT balance of $279,359. In rebuttal testimony, because the Company agreed that the acquired plant should have a lower tax basis, LDO reduced ADIT to $66,456.[51] The Company asserts that since it claimed bonus depreciation on the plant in 2012, when the tax basis of the plant declined, the calculation of ADIT is also reduced.[52] LDO states that for tax purposes, the tax basis now equals the net book value of the purchased assets of about $2.7 million rather than the full original cost of $3.8 million.[53]

50. Staff increased the amount of ADIT by $68,229, from $279,359 to $347,588.[54] Staff argues that because the plant acquired from SDC was placed in service over a period of many years, any "bonus" depreciation would have been available to the entity installing the plant in the year the plant was placed into service, and not to LDO in 2012 when it purchased the plant. Staff argues that LDO claiming the bonus depreciation which provided the Company with a tax benefit, may have been in error, and that from a ratemaking perspective should not detrimentally impact ratepayers.[55]

51. On its 2012 tax return, LDO claimed bonus depreciation based on plant with a tax basis of about $3.8 million. LDO offered pro forma adjustments that lowered the tax basis of the plant to about $2.7 million. There is, however, no evidence in this proceeding that LDO amended its 2012 tax return; consequently, we do not find that the pro forma adjustments are supported or

[50] Ex A-7 Bourassa Reb at 14.
[51] LDO Final Schedules at B-1.
[52] LDO Initial Brief at 6; LDO Final Schedules B-2, pages 7.0 and 7.1.
[53] LDO Initial Brief at 6.
[54] Ex S-3-A Rimback Surr at Schedule MJR-W3.
[55] Staff Opening Brief at 8.

appropriate.[56] Discarding these adjustments increases the tax basis by $568,294, which causes the ADIT balance to change from a $66,658 credit (rate base reduction) to a $148,137 ADIT debit (rate base increase).

52. Based on the foregoing, we adopt a FVRB of $7,578,641 as set forth below:

Gross Plant in Service	$18,200,198
Accumulated Depreciation	($9,977,386)
Net Plant in Service	$8,222,812
Less:	
AIAC	$297,640
CIAC	$852,693
Accum. Amort. of CIAC	($469,879)
Customer Meter Deposits	$111,854
ADIT	($148,137)
Total	$7,578,641

Operating Revenue and Expenses

53. The parties agree that in the test year, LDO had total revenues of $1,882,238. The Company proposed adjusted test year operating expenses totaling $1,936,561. Staff recommended adjusted test year expenses of $1,910,420.[57] The difference in total expenses of $26,141 is attributable to outside accounting services (LDO proposed $7,633, Staff recommended $533, a difference of $7,100), depreciation and amortization (LDO proposed $861,127 and Staff $820,530, a difference of $40,597) and Income Tax (LDO proposed a negative $85,557, Staff recommended a negative $64,002, a difference of negative $21,555.

54. The difference in the depreciation and amortization expenses is a result of the depreciation methodologies discussed above. As a result of our determination that the Broad Group method of accounting for depreciation is acceptable in this case, we adopt a test year depreciation and amortization expense of $861,127.[58]

[56] See Ex A-9 Bourassa Rj Schedule B-2 page 7.1.
[57] LDO Final Schedule C-1. Ex S-3A Rimback Surr Schedule LJR-W9.
[58] LDO Final Schedules at C-1.

55. In its rebuttal testimony, LDO increased "contractual services-accounting" by $8,000 for LDO's share of audit fees it claimed were going to be incurred as a requirement of obtaining its loan. At the time Staff filed its Surrebuttal Testimony, and at hearing, Staff did not agree that audit costs associated with the new loan should be allowed because Staff believed that there was insufficient documentation that the audit was a required condition of the loan.[59] Subsequent to the hearing, based on documentation provided by the Company, Staff and LDO agreed that a pro forma adjustment of $7,100 for the audit fees was appropriate.[60] We concur with the parties' final position that the audit costs, which enable LDO to obtain its lower-cost debt capital, are a benefit to ratepayers and an appropriate pro forma adjustment.

56. Based on our acceptance of the adjusted test year operating expenses as agreed to by the parties and discussed herein, test year income tax expense should be ($85,557).

57. Based on the foregoing, we find that in the test year, LDO had adjusted operating expenses totaling $1,936,561, which resulted in an operating loss of $54,323.

Cost of Capital

58. In the test year, LDO had a capital structure that consisted of 100 percent equity. In April 2014, in Decision No. 74450, the Commission authorized the Company to borrow up to $2,751,411 for the purpose of repaying shareholders for the purchase of the utility plant at the end of 2012. The Commission recognized in Decision No. 74450, and the parties asserted in the rate case, that the inclusion of reasonably priced long-term debt in LDO's capital structure benefits ratepayers by providing a lower WACC than if the Company were capitalized totally with equity.

59. Although the loan had not been consummated at the time of the hearing in this matter, based on the loan commitment documents provided by the prospective lending bank, the parties agreed that a cost of debt of 4.6 percent is fair and reasonable for purposes of setting rates.[61]

60. The parties agreed that including the proposed long-term loan in LDO's capital structure would result in a capital structure consisting of 29 percent debt and 71 percent common

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[59] Ex S-3-A Rimback Surr at 9.
[60] Staff Opening Brief at 11.
[61] Ex A-10 Bourassa CoC RJ at 2; Ex S-3-B Cassidy Surr at 2.

equity.[62]

61. At the hearing, the Company proposed a cost of equity of 10.50 percent, and based on the agreed capital structure and cost of debt, proposed a WACC of 8.79 percent.[63] At that time, Staff was recommending a cost of debt of 4.6 percent, and a return on equity of 9.7 percent, resulting in a WACC of 8.2 percent.[64] Subsequent to the hearing, the Company agreed to Staff's recommended return on equity of 9.7 percent, and consequently to a WACC of 8.2 percent.[65]

62. The Company utilized three different approaches to determine its proposed cost of equity. Mr. Bourassa utilized two versions of the constant-growth Discounted Cash Flow ("DCF") model (one with analyst estimates of growth and one using historic growth); the mid-point of Mr. Bourassa's DCF models was 9.0 percent. He utilized two versions of the Capital Asset Pricing Model ("CAPM")—one using an historical risk premium and the other based on a current market risk premium, with a midpoint of 9.1 percent. Mr. Bourassa's Build-up method was 11.4 percent. The three different models resulted in an average estimate for the cost of equity of 10.2 percent, with Mr. Bourassa recommending a cost of equity of 10.5 percent.[66]

63. Staff's DCF model analysis produced an estimated cost of equity of 8.7 percent under the constant-growth DCF model and 9.5 percent for its multi-stage DCF model, for an average of 9.1 percent. Staff added an upward economic assessment adjustment of 0.6 percent to arrive at its recommended return on equity of 9.7 percent.[67]

64. The parties' agreed cost of equity of 9.7 percent is within the range of results presented in testimony. We find that the WACC of 8.2 percent, derived from the parties' pro forma capital structure and cost of debt and equity, when applied to the FVRB, results in fair and reasonable rates in this case.

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[62] Staff Opening Brief at 3; LDO Initial Brief at 2.
[63] LDO Initial Brief at 2.
[64] Ex S-3-B Cassidy Surr at Exec. Summary.
[65] LDO Initial Brief at 3.
[66] Ex S-8 Bourassa CoC Reb at 2.
[67] Ex S-3-B Cassidy Surr at 6.

Revenue Requirement

65. Based on our findings here, we determine that LDO's gross revenues should increase by $1,105,253, or 58.72 percent, for a revenue requirement of $2,987,491, as set forth below:

FVRB	$7,578,628
Adjusted Operating Income	($54,325)
Current Rate of Return	-0.72%
Required Operating Income	$621,448
Required Rate of Return on FVRB	8.2%
Operating Income Deficiency	$675,772
Gross Revenue Conversion Factor	1.6355
Increase in Gross Revenue	$1,105,253
Adjusted Test Year Revenue	$1,882,238
Revenue Requirement	$2,987,491
% Increase	58.72

Rate Design

66. LDO's current rate design is based on minimum monthly charges that increase by meter size. With the exception of SaddleBrooke Golf Course there is a single commodity charge to all meter sizes of $1.80 per $1,000 gallons, with the first 2,000 gallons of usage included in the monthly customer charge. A separate tariff charges $0.37 per 1,000 gallons for irrigation provided to the SaddleBrooke Golf Course.

67. The Company proposed, and Staff recommends, removing the service charges for "Re-Establishment (After hours) $30.00", and adding a single After Hours Service Charge of $30.00 for all service calls after hours. The Company proposed, and Staff recommended, including a late payment charge of 1.5 percent per month. Staff recommends adopting the service line and meter installation charges reflected in the Engineering Report.[68]

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[68] Ex S-2-A Rimback Rate Dir at 3-4. Ex S-1-B Thomson Dir MT-1 at 20.

68. The Company's current rates, and those proposed by the Company, and recommended by Staff are set forth below:[69]

	Present Rates	- Proposed Rates - Company	Staff
MONTHLY USAGE CHARGE:			
Meter Size (All Classes)			
5/8" x 3/4" Meter	$ 12.40	$ 14.47	$ 14.15
3/4" Meter	12.40	14.47	14.15
1" Meter	18.00	24.12	23.59
1 ½" Meter	28.00	48.24	47.16
2" Meter	40.00	77.18	75.46
3" Meter	62.00	154.36	150.94
4" Meter	84.00	241.18	235.84
5" Meter	106.00	Remove	NT
6" Meter	128.00	482.36	471.66
8" Inch	150.00	771.78	754.66
Golf Course Irrigation	-	200.00	200.00
Construction Hydrant	NT	NT	NT
Gallons in Minimum (all classes except golf course)	2,000	--	--
Gallons in Minimum (golf course irrigation)	--	--	--
COMMODITY RATES:			
(per 1,000 gallons for all classes)			
5/8" x ¾" Meter			
All classes over Minimum	$ 1.80	N/A	N/A
Residential:			
First 4,000 gallons	N/A	$ 1.80	$1.55
4,001 to 10,000 gallons	N/A	2.90	3.00
Over 10,000 gallons	N/A	4.00	4.08
Commercial, Irrigation (Except Golf Course Irrigation)			
First 10,000 gallons	N/A	2.90	3.00
Over 10,000 gallons	N/A	4.00	4.08
3/4" Meter			
All classes over Minimum	$ 1.80	N/A	N/A
Residential:			
First 4,000 gallons	N/A	$ 1.80	$ 1.55
4,001 to 10,000 gallons	N/A	2.90	3.00
Over 10,000 gallons	N/A	4.00	4.08
Commercial, Irrigation (Except Golf Course Irrigation)			
First 10,000 gallons	N/A	2.90	3.00
Over 10,000 gallons	N/A	4.00	4.08

[69] Staff did not file Final Schedules, and its proposed rates are derived from its Surrebuttal Schedules. Although, the Company states that it and Staff agree on the proposed service line and meter installation charges, the Company's Final Schedules and Staff's Surrebuttal schedules indicate a minor discrepancy concerning the 5/8 x ¾ inch service line charge. *See* Ex A-7 Bourassa Reb at 22 and Ex A-1-C Thompson Dir MT-1 at 20. It appears that the Company agrees to accept Staff's proposed service line charge.

1" Meter			
All classes over Minimum	$ 1.80	N/A	N/A
All Classes Except Golf Course Irrigation, Hydrant			
First 17,000 gallons	N/A	$ 2.90	$ 3.00
Over 17,000 gallons	N/A	4.00	4.08
1 ½" Meter			
All Classes Over Minimum	$ 1.80	N/A	N/A
All Classes Except Golf Course Irrigation, Hydrant			
First 34,000 gallons	N/A	$ 2.90	$ 3.00
Over 34,000 gallons	N/A	4.00	4.08
2" Meter			
All Classes Over Minimum	$ 1.80	N/A	N/A
All Classes Except Golf Course Irrigation, Hydrant			
First 54,000 gallons	N/A	$2.90	$ 3.00
Over 54,000 gallons	N/A	4.00	4.08
3" Meter			
All Classes Over Minimum	$ 1.80	N/A	N/A
All Classes Except Golf Course Irrigation, Hydrant			
First 107,000 gallons	N/A	$ 2.90	$ 3.00
Over 107,000 gallons	N/A	4.00	4.08
4" Meter			
All Classes Over Minimum	$ 1.80	N/A	N/A
All Classes Except Golf Course Irrigation, Hydrant			
First 167,000 gallons	N/A	$ 2.90	$ 3.00
Over 167,000 gallons	N/A	4.00	4.08
6" Meter			
All Classes Over Minimum	$ 1.80	N/A	N/A
All Classes Except Golf Course Irrigation, Hydrant			
First 334,000 gallons	N/A	$ 2.90	$ 3.00
Over 334,000 gallons	N/A	4.00	4.08
8" Meter			
All Classes Over Minimum	$ 1.80	N/A	N/A
All Classes Except Golf Course Irrigation, Hydrant			
First 534,000 gallons	N/A	$ 2.90	$ 3.00
Over 534,000 gallons	N/A	4.00	4.08
Golf Course Irrigation			
All Gallons	$ 0.37	$ 0.85	$ 0.85
Hydrant/Construction			
All Gallons	NT	$ 4.00	$ 4.08

Monthly Service Charge for Fire Sprinkler Up to 8”	NT	NT	Per Rule*

* 2 percent of monthly minimum for a comparable size 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 for the primary water service line.

<u>METER AND SERVICE LINE INSTALLATION CHARGES</u>
Refundable pursuant to A.A.C. R14-2-405

	Current	Company Proposed			Staff Recommended		
		Service Line	Meter	Total	Service Line	Meter	Total
5/8” x 3/4” Meter	$250.00	$385.00	$155.00	$520.00	$415.00	$155.00	$570.00
3/4” Meter	275.00	415.00	205.00	620.00	415.00	205.00	620.00
1” Meter	300.00	465.00	265.00	730.00	465.00	265.00	730.00
1-1/2” Meter	450.00	520.00	475.00	995.00	520.00	475.00	995.00
2” Meter	625.00		-	-		-	-
2” Turbine	-	800.00	995.00	1,795.00	800.00	995.00	1,795.00
2” Compound	-	800.00	1,840.00	2,640.00	800.00	1,840.00	2,640.00
3” Meter	800.00		-	-		-	-
3” Turbine	-	1,015.00	1,620.00	$2,635.00	1,015.00	1,620.00	$2,635.00
3” Compound	-	1,035.00	2,495.00	3,630.00	1,035.00	2,495.00	3,630.00
4” Meter	975.00		-	-		-	-
4” Turbine	-	1,430.00	2,570.00	4,000.00	1,430.00	2,570.00	4,000.00
4” Compound	-	1,610.00	3,545.00	5,155.00	1,610.00	3,545.00	5,155.00
5” Meter	1,150.00		-	-		-	-
6” Meter	1,325.00		-	-		-	-
6” Turbine	-	2,150.00	4,925.00	$7,075.00	2,150.00	4,925.00	7,075.00
6”Compound	-	2,270.00	6,820.00	9,090.00	2,270.00	6,820.00	9,090.00
8” Meter	-						
8” or Larger	$1,500.00	ICB*	ICB*	ICB	ICB*	ICB*	ICB*

<u>SERVICE CHARGES</u>:	Present Rates	Proposed Rates Company	Proposed Rates Staff
Establishment	$ 25.00	$ 25.00	$ 25.00
Establishment (After Hours)	30.00	NT	NT
Reconnection (Delinquent)	25.00	25.00	25.00
Meter Test (if correct)	30.00	30.00	30.00
Deposit	**	**	**
Deposit Interest	**	***	***
Re-Establishment (Within 12 Months)	***	***	***
NSF Check	10.00	10.00	$10.00
Deferred Payment	1.5% per month	1.5% per month	1.5% per month
Meter Re-Read (If Correct)	15.00	15.00	15.00
Late Fee	NT	1.5% per month	1.5% per month
Service Calls – Per Hour	NT	NT	NT
After Hours Service Charge (a)	NT	30.00	30.00

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

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

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax. Per Commission rule 14-2-409(D)(5).

69. Based on the revenue requirement authorized herein, we find that the following rates and charges are fair and reasonable:

MONTHLY USAGE CHARGE:

Meter Size (All Classes)	
5/8" x 3/4" Meter	$ 14.50
3/4" Meter	14.50
1" Meter	24.25
1 ½" Meter	48.25
2" Meter	77.25
3" Meter	154.75
4" Meter	241.25
6" Meter	483.25
8" Inch	773.25
Golf Course Irrigation	200.00

COMMODITY RATES:
(per 1,000 gallons for all classes)

5/8" x ¾" Meter
Residential:

First 4,000 gallons	$1.60
4,001 to 10,000 gallons	3.15
Over 10,000 gallons	4.20

Commercial, Irrigation (Except Golf Course Irrigation)

First 10,000 gallons	3.15
Over 10,000 gallons	4.20

3/4" Meter
Residential:

First 4,000 gallons	$ 1.60
4,001 to 10,000 gallons	3.15
Over 10,000 gallons	4.20

Commercial, Irrigation (Except Golf Course Irrigation)

First 10,000 gallons	3.15
Over 10,000 gallons	4.20

1" Meter
All Classes Except Golf Course Irrigation, Hydrant

First 17,000 gallons	$ 3.15
Over 17,000 gallons	4.20

1 ½" Meter
All Classes Except Golf Course Irrigation, Hydrant

First 34,000 gallons	$ 3.15
Over 34,000 gallons	4.20

2" Meter
All Classes Except Golf Course Irrigation, Hydrant

First 54,000 gallons	$ 3.15
Over 54,000 gallons	4.20

3" Meter
All Classes Except Golf Course Irrigation, Hydrant

First 107,000 gallons	$ 3.15
Over 107,000 gallons	4.20

4" Meter
All Classes Except Golf Course Irrigation, Hydrant

First 167,000 gallons	$ 3.15
Over 167,000 gallons	4.20

6" Meter
All Classes Except Golf Course Irrigation, Hydrant

First 334,000 gallons	$ 3.15
Over 334,000 gallons	4.20

8" Meter
All Classes Except Golf Course Irrigation, Hydrant

First 534,000 gallons	$ 3.15
Over 534,000 gallons	4.20

Golf Course Irrigation

All Gallons	$ 0.85

Hydrant/Construction

All Gallons	$ 4.20

Monthly Service Charge for Fire Sprinkler Up to 8"	Per Rule*

* 2 percent of monthly minimum for a comparable size 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 for the primary water service line.

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

	Service Line	Meter	Total
5/8" x 3/4" Meter	$415.00	$155.00	$570.00
3/4" Meter	415.00	205.00	620.00
1" Meter	465.00	265.00	730.00
1-1/2" Meter	520.00	475.00	995.00
2" Turbine	800.00	$995.00	1,795.00
2" Compound	800.00	1,840.00	2,640.00
3" Turbine	1,015.00	1,620.00	2,635.00
3" Compound	1,135.00	2,495.00	3,630.00
4" Turbine	1,430.00	2,570.00	4,000.00
4" Compound	1,610.00	3,545.00	5,155.00
6" Turbine	2,150.00	4,925.00	7,075.00
6"Compound	2,270.00	6,820.00	9,090.00
8" or Larger	ICB*	ICB*	ICB*

SERVICE CHARGES:

Establishment	$ 25.00
Establishment (After Hours)	NT
Reconnection (Delinquent)	25.00
Meter Test (if correct)	30.00
Deposit	**
Deposit Interest	***
Re-Establishment (Within 12 Months)	***
NSF Check	10.00
Deferred Payment	1.5% per month
Meter Re-Read (If Correct)	15.00
Late Fee	1.5% per month
After Hours Service Charge (a)	30.00

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

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

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax. Per Commission rule 14-2-409(D)(5).

70. Under the rates approved herein, a 5/8 x ¾ inch meter residential customer consuming the median usage of 5,500 gallons, would see monthly charges of $25.62, an increase of $6.92, or 37.01 percent, over the current median monthly bill of $18.70.

Best Management Practices

71. ADWR regulates LDO under the Modified Non-per Capita Conservation Program ("MNPCCP") and as such LDO is required to implement a basic public education program plus five additional BMPs. On August 25, 2009, ADWR approved LDO's Public Education Program and five BMPs. The approved BMPs include: (1) Customer Inquiry Resolution for High Consumption (BMP #3.6); (2) High Consumption Notification for Customers (BMP #3.7); (3) Water Waste Investigations and Information (BMP #3.8); (4) Leak Detection Program (BMP #4.1); and (5) Meter Repair and Replacement (BMP #4.2).[70] For its Public Education Program, LDO provides water conservation tips and ideas in customer water bills each month and distributes Water Wise pamphlets at all clubhouses in SaddleBrooke and at the LDO office. Upon request, LDO will mail a pamphlet to a customer.

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[70] Ex S-1-B Thompson Dir Ex MT-1 at 21.

72. Staff recommended that LDO file with Docket Control, as a compliance item in this docket and within 90 days of the effective date of a Decision in this proceeding, at least seven (7) BMPs in the form of tariffs that substantially conform to the templates created by Staff for Commission review and consideration.[71] The templates created by Staff are available on the Commission's website at http://www.azcc.gov/Divisions/utilities/forms.asp. Staff states further that LDO may request cost recovery of the actual costs associated with the BMPs implemented in its next general rate case.

73. Staff argues that its recommendations to implement seven BMPs as tariffs "address implementation, notification of water company/customer requirements and notification of steps for service interruption" which are not addressed by ADWR filings.[72] Staff argues that the BMPs give water companies additional tools to prevent water loss at little or no cost and assist customers to use water efficiently and prevent excessively high bills.

74. LDO opposes Staff's BMP recommendations on the grounds they represent duplicative and excessive regulation. LDO argues that Staff could not cite a convincing reason to require LDO to file BMP tariffs when the Company already has approved BMPs and a public education program approved by ADWR. LDO cites two recent Decisions in which the Commission declined to impose a BMP obligation in excess of the ADWR requirements for utilities located in AMAs.[73] LDO argues that these Decisions indicate that the Commission recognizes that regulating groundwater protection is the province of ADWR. LDO asserts that Staff's only reason to recommend imposing the BMPs is a uniform policy and has nothing to do with LDO, its need for water conservation, or its track record of implementing existing water conservation measures.[74]

75. LDO is located in the Tucson AMA. The state's groundwater protection laws are already in place and enforced by ADWR. We do not find duplicative regulation to be in the public interest. We agree with LDO and will not require the filing of BMP tariffs.

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[71] The BMPs already approved by ADWR and the Public Education Program can comprise six of Staff's seven required BMPs. Tr. at 112. Ex S-1-B Thompson Dir, Ex MT-1 at 21 (as revised).

[72] Staff Opening Brief at 10.

[73] Ex A-2 Jones Reb at 4-5. *See* Decision No. 73573 (November 21, 2012) (Pima Utility Co.) and Decision No. 74294 (January 29, 2014 (New River Utility Co.).

[74] LDO Initial Brief at 8-9.

CONCLUSIONS OF LAW

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

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

4. LDO has a FVRB of $7,578,638.

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

ORDER

IT IS THEREFORE ORDERED that Lago Del Oro Water Company shall file with Docket Control, as a compliance item in this docket, by June 30, 2014, revised rate schedules setting forth the rates and charges approved herein.

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

IT IS FURTHER ORDERED that Lago Del Oro Water 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 or as a separate mailing.

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IT IS FURTHER ORDERED that, in addition to the collection of its regular rates and charges, Lago Del Oro Water Company shall collect from its customers a proportionate share of any privilege, sales or use tax per A.A.C. R14-2-409(D).

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 20th day of June 2014.

JODI JERICH
EXECUTIVE DIRECTOR

DISSENT ____________________

DISSENT ____________________
JR:ru

SERVICE LIST FOR: LAGO DEL ORO WATER COMPANY

DOCKET NO.: W-01944A-13-0215

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