OPEN MEETING ITEM

0000159033

SUSAN BITTER SMITH

JODI JERICH
Executive Director

ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
DOCKET CONTROL

2014 DEC 23 PM 1 48

DATE: DECEMBER 23, 2014

DOCKET NO.: W-02860A-13-0399

TO ALL PARTIES:

ORIGINAL

Enclosed please find the recommendation of Administrative Law Judge Jane L. Rodda. The recommendation has been filed in the form of an Opinion and Order on:

NACO WATER COMPANY, LLC
(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 2, 2015

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 13, 2015 and JANUARY 14, 2015

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 23 2014
DOCKETED BY

JODI JERICH
EXECUTIVE DIRECTOR

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 NACO WATER COMPANY, LLC FOR A PERMANENT INCREASE TO ITS WATER RATES.	DOCKET NO. W-02860A-13-0399 DECISION NO. ____________ **OPINION AND ORDER**

DATE OF HEARING:	September 4, 2014
PLACE OF HEARING:	Tucson, Arizona
ADMINISTRATIVE LAW JUDGE:	Jane L. Rodda
APPEARANCES:	Steve Wene, MOYES SELLERS & HENDRICKS LTD. on behalf of Naco Water Company, LLC; and Matthew Laudone and Bridget Humphrey, Staff Attorneys, Arizona Corporation Commission Legal Division on behalf of the 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 November 20, 2013, Naco Water Company, LLC. ("NWC" or "Company") filed with the Commission an Application for a rate increase.

2. On December 11, 2013, NWC filed an Amended Rate Application.

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3. On December 20, 2013, the Commission's Utilities Division ("Staff") notified the Company that its application was found not to have met the sufficiency requirements in Arizona Administrative Code ("A.A.C.") R14-2-103, and that the Company would have until January 6, 2014, to cure the indicated deficiencies.

4. On December 27, 2013, Staff requested, on behalf of the Company, for an extension until January 24, 2014, to respond to the insufficiency findings. The request was granted by Procedural Order dated January 3, 2014.

5. On January 24, 2014, NWC filed a Response to Staff's Letter of Deficiency.

6. On February 10, 2014, Staff notified the Company that its application was sufficient pursuant to A.A.C. R14-2-103, and classified NWC as a Class C utility.

7. By Procedural Order dated February 13, 2014, the matter was set for hearing on September 4, 2014, and other procedural deadlines were established.

8. On March 11, 2014, Staff filed a Request to Suspend the Time Clock indefinitely, on the grounds that NWC was not responding to Staff's data requests in a timely fashion.

9. By Procedural Order dated March 12, 2014, a Procedural Conference to discuss Staff's request was set for March 19, 2014. NWC and Staff appeared at the Procedural Conference through counsel. Staff expressed concerns that the delay in receiving responses to its data requests would not allow Staff to prepare its testimony by the deadline set in the Rate Case Procedural Order. Both parties agreed to a modification of the procedural schedule that would extend the deadline for filing testimony, but keep the hearing date.

10. By Procedural Order dated March 20, 2014, the procedural schedule was modified as agreed.

11. On March 26, 2014, NWC filed a Notice of Mailing and Publication of Public Notices, attesting that the notice of the hearing in this matter was mailed to NWC's customers on February 27, 2014, and published in the *Bisbee Observer* on March 6, 2014.

12. On July 11, 2014, Staff filed the Direct Testimony of Phan Tsan and Dorothy Hains.

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13. On July 24, 2014, NWC filed a Motion to Extend the Time to File its Rebuttal Testimony, seeking an extension from August 1, 2014 to August 4, 2014, due to its counsel's schedule. Staff did not object, and the request was granted by Procedural Order dated July 30, 2014.

14. On August 4, 2013, NWC filed the Rebuttal Testimony of Matthew Rowell and Bonnie O'Connor.[1]

15. On August 18, 2014, Staff filed the Surrebuttal Testimony of Ms. Tsan and Ms. Hains.

16. On August 29, 2014, NWC filed the Rejoinder Testimony of Mr. Rowell and Ms. O'Connor.

17. The hearing convened as scheduled on September 4, 2014, before a duly authorized Administrative Law Judge at the Commission's offices in Tucson Arizona. Mr. Rowell, Ms. O'Connor, and Mr. Kevin Dejaquez, SUM's Operations Manager, testified for the Company, and Ms. Phan and Ms. Hains testified for Staff.

18. On October 9, 2014, NWC filed a Notice of Filing Post-Hearing Documents and Request to Extend the Time clock. NWC attached a summary of rate base adjustments; a summary of WIFA Payment Policies; a report regarding meter purchase and installation costs; and a rate case expense report. NWC agreed to extend the time clock in A.A.C. R14-2-103 until December 31, 2014, in order to provide the Commission sufficient time to review and consider the post-hearing documents.

19. On October 17, 2014, Staff filed a Response to Notice of Filing Post-Hearing Documents.

20. By Procedural Order dated October 29, 2014, the parties were requested to file supporting documentation relating to their calculations of accumulated depreciation and for billing determinants.

21. On October 30, 2014, Staff filed its Response to the October 29, 2014 Procedural Order.

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[1] Mr. Rowell, a managing member of Desert Mountain Analytical Services ("Desert Mountain"), is a rate case consultant and Ms. O'Connor owns Southwestern Utility Management ("SUM") which has managed NWC for 18 years. Ex. A-1 Rowell Dir at 2; Hearing Transcript ("Tr.") at 8.

22. By Procedural Order dated October 31, 2014, the Company was requested to file additional information related to its October 9, 2014 Post-hearing Documents concerning NWC's specific projected debt service costs.

23. On November 7, 2014, NWC filed a Response to the October 29, 2014 Procedural Order, providing its accumulated depreciation calculation and its billing determinants.

24. On November 17, 2014, NWC filed a Motion for Extension of Time requesting additional time beyond November 17, 2014, to provide the data requested in the October 31, 2014 Procedural Order.

25. By Procedural Order dated November 18, 2014, NWC's request for more time was granted and the time clock under A.A.C. R14-2-103 for a final order was indefinitely suspended.

26. On December 2, 2014, Staff filed a Response to the October 29, 2014 Procedural Order, indicating it had reviewed the additional information filed by the Company and that its recommendations made at the hearing are unchanged.

27. On December 9, 2014, Naco filed a Response to Issues Raised in the October 31, 2014 Procedural Order.

28. The Commission received six written customer comments in opposition the requested increase.

Background

29. NWC is a Class C utility engaged in providing water service to approximately 375 customers in portions of Cochise County, Arizona, in and around the town of Naco.

30. NWC's current rates were approved in Decision No. 69393 (March 22, 2007). In Decision No. 69393 the Commission also authorized NWC to borrow up to $1,160,000 from the Water Infrastructure Finance Authority ("WIFA").

31. In its current rate application, NWC asserts that it filed for rate relief because its Debt Service Coverage Ratio ("DSC") fell to 0.91, which is below the 1.2 DSC required by WIFA.[2] The Company believes that the implementation of tiered rates in the last rate case caused a number of its

[2] Ex A-1 Rowell Dir at 3.

customers to reduce their usage, which impacted the Company's ability to attain the revenue requirement established in the last rate case.[3] Despite its positive rate base, NWC did not prepare a cost of capital analysis because it believes such an exercise is burdensome for a small company.[4] Consequently, NWC based its proposed revenue requirement on a cash flow analysis.

32. In its Amended Application, NWC reported total adjusted revenues for the test year ended December 31, 2012 ("test year"), of $255,089, and total adjusted operating expenses of $229,124, resulting in operating income of $25,965, a 1.72 percent return on the Company's proposed Fair Value Rate Base ("FVRB") of $1,508,251.[5]

33. In its final position, as set forth in Rebuttal Testimony, the Company seeks total revenues of $306,330, an increase of $51,241 or 20.0 percent, over test year revenues.[6] After proposed adjusted operating expenses of $238,387, the Company would have operating income of $67,943, a 5.0 percent rate of return on the revised Company-proposed FVRB of $1,357,183.[7]

34. Staff recommended adjusted test year revenues totaling $255,089, and adjusted operating expenses of $195,068, which produce test year operating income of $60,021, a rate of return of 4.3 percent on Staff's adjusted test year FVRB of $1,394,639.[8]

35. Staff recommends total revenues of $287,231, an increase of $32,142, or 12.6 percent, over test year revenues, and adjusted operating expenses totaling $201,355, resulting in operating income of $85,876, a 6.16 percent rate of return on Staff's recommended FVRB.[9]

36. In addition to certain adjustments to rate base and operating income, Staff further recommends that NWC: (1) bring its books and records into compliance with National Association of Regulatory Utility Commissioners ("NARUC") Uniform System of Accounts ("USoA") by December 31, 2014, and file an affidavit with the Commission confirming compliance with this

[3] In its last rate case, the Commission approved a revenue requirement of $316,605. Decision No. 69393 at 12.
[4] Ex A-1 Rowell Dir at 7.
[5] Ex A-1, Amended Application at Schedules C-1 and B-1.
[6] Ex A-3 Rowell Reb at Schedule C-1.
[7] The Company's rate base changed in its Rebuttal Testimony because the Company accepted Staff's recommendation to include post-test year plant which was funded entirely by Contributions In Aid of Construction ("CIAC"). Ex A-3 Rowell Reb at Schedule B-2.
[8] Ex S-3 Tsan Dir at schedules PNT-3 and PNT-11.
[9] *Id.* at PNT-3.

condition by January 30, 2015;[10] (2) implement the Company's water loss plan immediately and file water loss reduction progress reports each January and July;[11] and (3) file five Best Management Practices ("BMP") tariffs within 90 days.[12]

37. Staff reports that its Utilities Division Section database as of May 2014, showed no delinquent compliance items for NWC. Staff's Consumer Service records for the period January 1, 2011, through the date of Direct Testimony showed that two complaints were filed in 2011; no complaints in 2012; four complaints in 2013; and four complaints in 2014. Staff states that all complaints were resolved and closed.[13]

38. In the test year, NWC was comprised of three water systems: (1) the Township System (Arizona Department of Environmental Quality ("ADEQ") Public Water System ("PWS") No. 02-024) which has two wells with a combined production capacity of 302 gallons per minute ("GPM"), combined storage capacity of 170,000 gallons, two pressure tanks, two booster pump stations, and which serves approximately 250 customers; (2) the Bisbee System (PWS No. 02-112) which has one well with a 20 GPM production capacity, a 20,000 gallon storage tank, one booster pump station, and which serves approximately 60 customers; and (3) the Bisbee Highway System (PWS No. 02-133) which has one 20,000 gallon storage tank, one pressure tank, one booster pump station, and which serves approximately 12 customers. In March 2013 (after the test year) the Bisbee Highway System was interconnected with the Township System.[14]

39. Well No. 3 which had been serving the Bisbee Highway System has been abandoned, and the wells serving the Township System are serving both systems by means of a new interconnection that was constructed with funds provided by Freeport McMoRan, the operator of a nearby mine.

40. In 2007, Phelps Dodge Corporation, the predecessor of Freeport McMoRan, entered into a consent order with ADEQ to address the formation of a sulfate plume in the aquifer underlying its mine tailings impoundment. Two of NWC's wells located approximately three miles down

[10] *Id.* at 19.
[11] Ex S-1 Hains Dir at 5-6.
[12] *Id.* at 6.
[13] Ex S-3 Tsan Dir at 2-3.
[14] Ex S-1 Hains Dir Ex DMH-1 at 2-4.

gradient from the tailings showed elevated levels of sulfate concentration. As a result, Freeport McMoRan began working with the Company to mitigate the impact of the sulfate plume on the Company, and on June 20, 2011, Freeport McMoRan agreed to pay the capital costs of replacing a significant amount of NWC's plant in order to allow the Company to pump its water from a well not affected by the sulfate plume.[15] Sulfate is a secondary contaminant that affects the smell of the water.[16]

41. Staff concludes that the Township System, which now includes the Bisbee Highway System, has adequate production and storage capacity to serve its current customer base and reasonable growth.[17] Staff also concludes that the Bisbee System has adequate production and storage capacity to serve its current customer base and reasonable growth.[18] Staff notes that the production capacity of Well No. 4 serving the Bisbee System has declined by 50 percent since the 2006 rate case. Staff states that if the Company conducts a hydrology/engineering evaluation of Well No. 4, that it should file the resultant report with Docket Control.[19]

42. ADEQ reports that all of NWC's water systems have no major deficiencies and are 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.[20]

43. NWC is not located in an Arizona Department of Water Resources ("ADWR") Active Management Area ("AMA"). According to an ADWR compliance status report dated November 29, 2013, the Company is currently in compliance with ADWR requirements governing water providers and/or community water systems.[21]

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[15] Ex A-1 Rowell Dir at 4. NWC began receiving reimbursements for its capital expenditures during the test year. The new plant went into service after the end of the test year and originally the Company did not include the plant in rate base as CIAC.

[16] Tr. at 74. As a note: the improvements funded by Freeport McMoRan comprise the post-test year plant at issue in this case.

[17] Ex S-1 Hains Dir Ex DMH-1 at 5.

[18] *Id.*

[19] *Id.*

[20] *Id.* Ex DMH-1 at 10.

[21] *Id.* PWS No. 02-133 is considered "inactive" by ADWR and has been interconnected with and made part of PWS No. 02-024.

44. Staff states that the Commission's Compliance Section database dated January 27, 2014, showed no delinquent compliance items for NWC.[22]

45. NWC has approved Cross Connection and Curtailment tariffs on file with the Commission.[23]

46. The Company confirmed that it is current on its property taxes.[24]

Rate Base

47. The Company proposes a FVRB of $1,357,183,[25] while Staff recommends a FVRB of $1,394,639.[26] The difference between the two of $37,456, is the result of Staff disallowing various plant and asset items for not being used and useful, which affects various plant accounts, accumulated depreciation, CIAC and accumulated amortization.

48. Staff's first rate base adjustment removed $2,357 that had been recorded under Distribution Reservoirs and Standpipes (account 330), and reclassified $1,648 to Pumping Equipment (account 310) and $709 to Pressure Tanks (account 330.2), which is a subaccount of the Distribution Reservoirs and Standpipe account.[27] The Company accepts the reclassification from account 330 to 310, but does not want to use subaccounts.[28] The Company argues that its use of a single account has not led to problems, and that this accounting practice should be left to the discretion of management.[29]

49. Staff believes that using subaccounts will assist in the processing of future rate cases. Staff does not insist that the Company re-do its past books and records, but on a going-forward basis should utilize subaccounts for sub-categories of equipment.[30] The use of appropriate sub-accounts, however, makes audits easier and in this case might have saved time and effort by all parties, with the result of minimizing rate case expense. We believe that when plant items have different depreciation

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[22] Ex S-1 Hains Dir at 4.
[23] *Id.*
[24] December 9, 2014 Response at 3.
[25] Ex A-3 Rowell Reb at MJR-1.
[26] Ex S-3 Tsan Dir at PNT-3.
[27] *Id.* at PNT-4 and PNT-5. Staff adjustment no. 1 reclassified only $709 to the pressure tank subaccount, but adjustment no. 3 added $303,227 to Storage Tank account (330.1) and $10,448 to the Pressure Tank Account (330.2) as part of including the post-test year plant.
[28] Post-Hearing Summary of Adjustments at Exhibit 1; Ex A-1 Rowell Reb at 2.
[29] Ex A-1 Rowell Reb at 2.
[30] Tr. at 210.

rates, as they do here, using subaccounts is reasonable and appropriate, and that setting up such accounts on a going-forward basis should not be time-consuming or expensive for NWC. We find that NWC should use subaccounts when booking new plant assets that have different depreciation rates.

50. Staff's rate base adjustment no. 2 removed $267,430 from Transmission and Distribution Mains (account 331), reclassifying $225,051 to Services (account 333), $37,100 to Meters and Meter Installation (account 334), and $5,279 to Wells and Springs (307). In addition, Staff recommended disallowing $6,721 for the cost of a water trailer that Staff believes is already included in the Transportation account, and $11,748 for the capitalized costs associated with the 2006 rate case and a WIFA grant application that did not result in receiving a grant.[31] The Company accepts the reclassifications, but disagrees that the water trailer has been double counted, and believes that only $2,571 should be disallowed, resulting in a difference between the parties of $15,897.[32]

51. Although in its Post-Hearing filing, the Company states that it disagrees that the water trailer was double-counted, at the hearing, Mr. Rowell testified that the trailer was fully depreciated and the Company would not pursue this objection further.[33] The evidence of whether the trailer was double-counted is intricate, involving a detailed analysis of invoices.[34] Beyond denying that the asset was double-counted, the Company did not rebut Staff's testimony. We accept Staff's position with respect to the trailer. Staff's recommended removal of the 2006 rate case expenses and the costs of the unsuccessful WIFA grant application are also reasonable. Thus, we accept Staff's rate base adjustment no. 2.

52. Staff's third rate base adjustment added post-test year plant totaling $1,182,522 associated with the Freeport McMoRan-funded improvements.[35] The Company did not originally include the Freeport McMoRan plant in this rate case, but does not contest its inclusion. The Company argues however, that if post-test year plant is to be included in rate base, the proper amount

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[31] Ex A-3 Tsan Dir at PNT-6.
[32] Post-Hearing Summary of Adjustments at Exhibit 1.
[33] Tr. at 144-145.
[34] Tr. at 196-200.
[35] Ex S-3 Tsan Dir at PNT-4 and PNT-7. The additions increased Structures and Improvements by $4,183, Wells and Springs by $342,269, Pumping Equipment by $49,405, Storage Tanks by $303,227, Pressure Tanks by $10,448, and Transmission and Distribution Mains by $472,990.

is $1,190,902. The difference between the Company's position and Staff's is $8,380, which is associated with Staff's recommended disallowance of a safety wash station ($2,800), concrete slab, fencing and a shed ($4,000) located at Well Site No. 3 on the grounds that Staff believed those items are not used and useful, and a disallowance for meters in the amount of $1,580.[36]

53. Staff testified that the well at Site No. 3 was abandoned and Staff believed that the current facilities at Well Site No. 3 (wash station, concrete slab, fencing and shed) were not being used to provide service.[37] Staff's schedules and testimony do not explain the meter adjustment. The Company witnesses, however, testified that the storage shed, which is set on the concrete slab and protected by the fence, is used for storing chemicals, and that the safety equipment serves a beneficial purpose for employees in the field.[38] The evidence supports a finding that the concrete pad, shed, fencing and the safety equipment at the Well Site No. 3, in addition to the meters, are currently used and useful and should not be removed from the rate base calculation.[39] Thus, we find that the appropriate adjustment for post-test year plant is $1,190,902.

54. Staff's fourth rate base adjustment removed $49,711 to reflect retirements associated with bringing the post-test year plant into service. The Company agrees with this adjustment. We also find Staff's recommendation to be reasonable, and accept it.

55. Staff's fifth rate base adjustment increased accumulated depreciation by $69,678, for an accumulated depreciation balance of $740,486, to reflect Staff's other rate base adjustments.[40] The Company believes that based on its proposed rate base values, accumulated depreciation should be $730,979, resulting in a difference of $9,507.[41] Given our previous findings on plant balances, we find that accumulated depreciation should be $740,665.[42]

56. Staff's sixth rate base adjustment adds $1,182,522 to CIAC and $24,246 to accumulated amortization of CIAC in the calculation of FVRB, in order to account for the post-test

[36] Ex S-1 Hains Dir Ex DMH-1 at 14-15; Tr. at 177.
[37] Ex S-1 Hains Dir Ex DMH-1 at 15.
[38] Tr. at 29-30 and 72-75.
[39] We note that these assets are part of the post-test year plant that was funded by CIAC.
[40] Ex S-3 Tsan Dir at PNT-9.
[41] Post-Hearing Summary of Adjustments at Exhibit 1. At hearing, the Company was relying on its Rebuttal position which included Accumulated Depreciation of $784,227. Ex A-3 Rowell Reb at B-2.
[42] Based on Staff's methodology, but including the Well Site No. 3 assets.

year plant that was contributed by Freeport McMoRan.[43] The Company argues that based on its recommended post-test year values, the adjustment should be to add $1,190,902 to CIAC and $18,788 to accumulated amortization of CIAC.[44] Based on including the assets at Well Site No. 3 in the rate base calculation, we find gross CIAC should be $1,231,035 and accumulated amortization of CIAC should be $50,399, which results in a combined CIAC and Advances in Aid of Construction ("AIAC") of $1,201,389.

57. Based on the foregoing, we find that NWC's Original Cost Rate Base ("OCRB") is $1,394,622, as summarized below:

Plant in Service:

Account #	Description	Balance
302	Franchises	$198
303	Land & Land Rights	4,345
304	Structures and Improvements	14,101
307	Wells & Springs	458,799
311	Pumping Equipment	224,032
320	Water Treatment Equipment	1,824
330	Distribution Reservoirs & Standpipe	127,321
330.1	Storage Tanks	303,227
330.2	Pressure Tanks	11,157
331	Transmission & Distribution Mains	1,686,089
333	Services	361,890
334	Meters & Meter Installations	85,480
335	Hydrants	34,717
339	Other Plant & Miscellaneous Equipment	--
340	Office Furniture & Equipment	9,202
341	Transportation Equipment	20,298

[43] Ex S-3 Tsan Dir at PNT-10.
[44] Post-Hearing Summary of Adjustments at Exhibit 1, see also November 7, 2014 filing regarding accumulated depreciation.

343	Tools, Shop and Garage Equipment		128	
345	Power Operated Equipment		2,818	
	Total Plant In Service		3,345,626	
	Accumulated Depreciation		(740,665)	
	Total Net Plant In Service		2,604,961	

Rate Base:

Plant in Service		3,345,626
Less: Accumulated Depreciation		(740,665)
Net Plant in Service		2,604,961
LESS:		
Advances in Aid of Construction		20,753
Contributions in Aid of Construction	1,231,035	
Less Accumulated Amortization of CIAC	50,399	
Net CIAC	1,180,636	
Total Advances and Contributions		1,201,389
Customer Deposits		8,950
Accumulated Deferred Income Taxes		--
Total Rate Base		1,394,622

NWC did not submit Reconstruction Cost New less Depreciation schedules, and thus, its FVRB is the same as its OCRB.

Operating Income

58. Staff did not recommend any adjustment to the Company's reported total adjusted test year operating revenues of $255,089.[45]

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[45] Test year revenues consist of $248,165 in metered water sales and $6,924 in Other Operating Revenue.

59. The Company proposes adjusted test year operating expenses totaling $227,054,[46] while Staff's adjusted test year operating expenses were $195,068,[47] a difference of $31,986. The areas of significant dispute affected office supplies and expenses and rate case expense.

60. NWC reported costs of $33,446 under office supplies and expense. Staff removed $27,250 from office supplies and expenses related to fees associated with the Company's WIFA loan.[48] Staff moved these costs to interest expense which is not an operating expense and is recorded "below the line." Staff also reclassified $2,250 of office supplies and expenses to contractual services – billing, and reclassified $3,926 to miscellaneous expense. Staff recommended that the Company not use the office supplies and expense account because it is not one of the accounts included in NARUC's USoA.[49]

61. The Company argues that WIFA fees should be treated as any other loan fees as part of operating expenses, and the Company also argues that although office supplies and expense is not among the NARUC USoA, there is a long history of its use in Arizona as an appropriate account to classify office expenses.[50]

62. We agree that the office supplies and expense account can be used in Arizona, however, it is intended as an account to record office related expenses not readily classified elsewhere, and is not intended to capture WIFA fees. The Commission treats WIFA's administrative fees as part of the debt service for the loan and includes these amounts with interest expense "below the line" as recommended by Staff in this matter. Staff's other adjustments to the office supplies and expense account merely reclassified costs to other operating expense accounts. Thus, for purposes of this rate case, we adopt Staff's recommended office supplies and expense balance of zero, however, in the future, absent a Commission directive to the contrary, NWC may utilize an office supplies and expense account for appropriate office expenses.

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[46] *See* Ex A-3 Rowell Rub Schedule C-1 adjusted to reflect the Company's offer to seek normalized Rate Case Expense of $10,000.
[47] Ex S-3 Tsan Dir at PNT-11.
[48] *Id.* at PNT-14.
[49] Ex S-3 Tsan Dir at 12.
[50] Ex A-3 Rowell Reb at 5.

63. Staff accepted the Company's initial estimate for rate case expense of $27,690, and normalized that figure over five years, to arrive at a normalized rate case expense of $5,538.[51] In Rebuttal, the Company revised its initial estimate and proposed an annual rate case expense of $12,500, based on a total rate case expense of $50,000 amortized over four years.[52] Staff did not change its position because the Company did not provide a breakdown of the revised costs.[53] As part of its Post-Hearing documents, the Company submitted a rate case expense Report to provide documentation for the increased rate case expense request.[54] Although the revised expenses were a little greater than $50,000, the Company offered to extend the normalization period to five years, as recommended by Staff, resulting in a normalized rate case expense of $10,000.[55]

64. NWC explained that in preparing its initial Rate Case Expense estimate, it assumed that Desert Mountain would work on the rate case less than 145 hours and that the Moyes Seller and Hendricks law firm would work less than 98 hours based on their experience with typical small company rate cases. In this case, however, the Company believes that the number of Staff data requests required much more work by the consultants, lawyers and SUM than anticipated, much of it focused on the post-test year plant that the Company had not initially requested be included in FVRB.[56] Through the end of the rate case, SUM estimates that the final cost of its services would be $11,830, Desert Mountain estimates a total cost of $15,680 and Moyes Sellers estimates a final cost of $24,000. The consultants provided sworn affidavits in support of their estimates.[57] Staff did not alter its initial recommendation based on the additional information provided by the Company.[58]

65. Staff did not argue that the Company's estimated rate case expense was unreasonable. The Company has provided evidence to support a total rate case expense of at least $50,000. The request to normalize the rate case expense over five years is reasonable, and thus, we adopt a rate case expense for purposes of this rate case, of $10,000.

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[51] The Company had initially normalized the Rate Case estimate over three years for an annual expense amount of $9,230.
[52] Ex A-3 Rowell Reb at 7-8 and Schedule MJR-7.
[53] Tr. at 205.
[54] Post-Hearing Documents at Attachment 4.
[55] *Id.* at 2. $50,000 normalized over 5 years.
[56] *Id.* at 3; Tr. at 97-106.
[57] Post-Hearing Documents at Attachment 4 at 4-5 and Attachments 1-3.
[58] Staff's December 2, 2014 Response.

66. The difference in depreciation expense reported by the parties is related to their different recommended plant values. Based on our determination of rate base amounts, and employing Staff's methodology of not continuing depreciation expense on fully depreciated plant, we adopt a depreciation expense of $53,963.

67. We find that in the test year NWC had an adjusted operating income of $54,303 based on revenues of $255,089 and adjusted operating expenses of $200,786,[59] which resulted in a 3.89 percent rate of return on its adjusted FVRB of $1,394,622.

Revenue Requirement

68. In the test year, NWC's capital structure included debt totaling $1,208,258 (72.31 percent), and equity of $462,570 (27.69 percent). NWC's debt, which consists of two WIFA loans--the first issued in 2000 in the original amount of $671,000 at an interest rate of 0.735 percent, had an outstanding balance at the end of 2013 of $171,832, and the second issued in 2008 in the original amount of $1,160,000, at a 0 percent interest rate, had a balance of $969,934 as of the end of 2013.[60] NWC used a composite cost of debt of 0.13 percent for purposes of determining its cost of capital.[61]

69. For purposes of its cost of capital analysis, Staff testified that it used the Company's reported capital structure and cost of debt.[62]

70. Although the Company has a positive rate base, NWC did not utilize a traditional rate-of-return analysis to determine its revenue requirement. Mr. Rowell testified for the Company that with a cost of equity in the range of 9-10 percent, which he states Staff and the Commission have been utilizing in recent rate cases, revenues would not result in a DSC ratio that would meet WIFA's

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[59] The Company did not submit revised schedules reflecting its updated Rate Case Expense and did not provide its assumptions used for interest synchronization. Total Operating Expenses as well as interest expense affect the calculation of Income Tax Expense. The evidence supports a cost of debt of 2.4 percent which is the result of the debt outstanding ($1,208,258) as reported by the Company divided by the interest expense ($28,981) as determined under Staff's methodology which includes the WFIA fees. The weighted average cost of debt is 1.73 percent (2.4% x 72.3%), which results in an Income Tax Expense of $5,792.

[60] Tr. at 151. Note that the balance of the loans at the end of 2013 is different than in the test year which is the year ended 2012.

[61] Ex A-1 Rowell Dir at Schedule D-1. NWC did not provide the underlying assumption behind its proposed weighted average cost of debt. In any case, NWC's calculation is understated because it does not include the WIFA loan fees.

[62] Tr. at 232. In its interest synchronization, however, Staff appears to use a weighted average cost of debt of 2.26 percent (Ex S-3 Tsan Dir at PNT-20) As discussed earlier, we find that the evidence supports a weighted average cost of debt of 1.7 percent, which should be used for both the interest synchronization and cost of capital analyses.

requirements.[63] NWC asserted that based on its proposed rate base and adjusted operating expenses in this case, in order to provide the Company with sufficient cash flow, the return on equity would need to be 15.8 percent.[64]

71. NWC proposed rates based on a cash flow analysis, which looked at how much cash, after operating expenses and debt service, management believes that the Company needs as a cushion for unexpected expenses and contingencies.[65] NWC believes that a free cash flow of approximately $50,000 is needed for this company to provide adequate service.[66] NWC proposed rates that would generate total revenues of $306,330, which after the Company-proposed operating expenses of $238,387, would result in operating income of $67,943, a 4.87 percent rate of return on the adjusted FVRB adopted herein. According to the Company, its proposed revenues produce a DSC before tax of 1.63 and after tax DSC of 1.45.[67] In its analysis and calculations, NWC did not include a provision for WIFA's Debt Service Reserve Fund or WIFA's required Repair and Maintenance Fund, and considered WIFA fees as part of operating expenses instead of as part of debt service costs.[68]

72. Staff testified that using a cost of equity in line with other recent rate cases would not provide sufficient cash flow for NWC to provide adequate service.[69] As a result, Staff utilized a cash flow analysis to arrive at its recommended revenue requirement of $287,231. After Staff's recommended operating expenses, Staff's proposed revenue would yield operating income of $85,875, and according to Staff, a cash flow after debt service of $40,000.[70] Staff's recommendation results in a rate of return of 6.16 percent on the FVRB adopted herein, and an after tax DSC of 1.4.

73. In the additional information the Company filed on December 9, 2014, the Company clarified that its revenue has not been sufficient to make its debt service payments and also make its

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[63] Ex A-1 Rowell Dir at 7.
[64] *Id.*
[65] *Id.*; Tr. at 91-92, 109-112, 161-162.
[66] Ex A-4 Rowell RJ at Attachment 5. The Company's chart shows cash flow of $32,790, but it includes $16,800 associated with a leak detection and meter replacement program which should not be deducted to determined cash flow as they are not currently mandated. NWC included the WIFA fees as part of operating expenses instead as part of debt service costs. Typically, capital projects are not included in the calculation of free cash flow, and it does not appear that the costs of a leak detection program would be capitalized in any event.
[67] Ex A-4 Rowell RJ at Attachment 5.
[68] Tr. at 161.
[69] Ex S-3 Tsan Dir at 16; Tr. at 232-233.
[70] Ex S-3 Tsan Dir at 16 and PNT-21. Staff did not include contributions to a WIFA required Repair and Maintenance Fund as part of debt service costs.

contributions to the WIFA Repair and Maintenance Reserve Fund. As a result, WIFA has been drawing on the Repair and Maintenance Reserve Fund to service its loans, with the result that the Company is not in arrears on its principal or interest obligations to WIFA, but the Repair and Maintenance Reserve Fund associated with its 1999 loan is underfunded by $12,428, and the Repair and Maintenance Reserve Fund associated with the 2007 loan is underfunded by $19,087.21.[71] In addition, the Company reported that including the amount due on December 10, 2014, NWC owes SUM $55,432.21.[72] The Company indicates that it expects the WIFA debt service obligation to remain at current levels—that is, annual principal payments on both loans of $70,778 and interest expense of $28,986.

74. Both parties in this case assumed that the Commission would not adopt a cost of equity for this Company in this rate case in the range of 15-16 percent, and thus, did not engage in a rate-of-return analysis to determine the revenue requirement. This Company, however, has a FVRB in excess of $1,000,000. Whenever possible, the Commission determines a fair and reasonable return on a utility's investment in plant serving the public to set rates. In such cases, the cash flow analyses used by the parties in this case can be a check on the reasonableness of the rates but should not replace a rate-of-return analysis to set rates unless necessary. NWC is heavily leveraged with very low cost debt, which skews the cost of capital to the low end. The Company also carries a large amount of CIAC which is a no-cost form of financing capital investment and reduces rate base. Despite this, NWC has a positive rate base high enough to utilize rate-of-return to determine fair and reasonable rates. The cost of capital and authorized rate of return for utilities is based on their individual capital structures and costs. NWC, with its unique circumstance cannot be directly compared to "typical" utilities without an understanding of the circumstances in the other cases. Neither party provided such comparison. NWC is a small, highly leveraged utility with limited access to the capital markets and an unusually low cost of debt. Given this background, we find that a cost of equity in the range of 16.0 percent is not unreasonable.[73] Based on a capital structure

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[71] Naco's December 9, 2014 Response at 2-3. The under-funded portions are treated as accounts payable.

[72] *Id.*

[73] Staff's recommended weighted cost of capital of 6.1 percent is based on a cost of debt of 3.1 percent and cost of equity of 14.2 percent. The Company's weighted average cost of capital of 5.01 percent is based on a cost of debt of 0.1 percent and cost of equity of 17.8 percent.

composed of 72.31 percent debt, at an average cost of debt of 2.4 percent, and 27.69 percent equity at a cost of 16.0 percent, NWC has a weighted cost of debt of 1.73 percent, a weighted cost of equity of 4.43 percent, and a weighted average cost of capital of 6.1 percent.[74]

75. We find that under the circumstances of this case, that a rate of return on FVRB of 6.1 percent is reasonable. Applying the fair value rate of return of 6.1 percent to the FVRB of $1,394,622 results in operating income of $85,909 and a revenue requirement of $295,243, which is an increase of $40,154, or 15.7 percent, over test year revenues.[75] This revenue level results in a cash flow after debt service, including contributions to the WIFA Reserve Fund, of $20,161, and a DSC before taxes of 1.54 and DSC after taxes of 1.4, as demonstrated below:

Operating Revenue	$295,243
Operating Expenses:	
Operation and Maintenance	128,246
Depreciation	53,963
Property and other Taxes	13,391
Income Tax	13,733
Total Operating Expense	209,334
Operating Income	85,909
Less Interest Expense	28,981
Less Principal Repayment	70,778
Cash Flow from Operations before WIFA Reserve	40,113
Less WIFA Reserve (20% of Principal and Interest)	19,952
Cash Flow from Operations after WIFA Reserve	20,161
DSC Before Tax	1.54
DSC After Tax	1.40

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[74] This weighted cost of capital comports with the overall rate of return recommended by Staff, although Staff utilized different cost components.

[75] The authorized revenue requirement is lower than the $316,605 revenue requirement authorized in the last rate case. *See* Decision No. 69393 at 12.

The cash flow after debt service and the WIFA Reserve Fund is available for contingencies, a meter replacement program, to reduce accounts payable, or other purposes as determined appropriate by management. We believe this revenue level is equitable to the Company and ratepayers and will allow this Company to meet its financial obligations and continue to provide reliable service.

Rate Design

76. NWC's current rates and charges, and those being proposed by the Company and recommended by Staff based on their recommended revenue requirements, are set forth below:[76]

	Present Rates	Proposed Rates Company	Proposed Rates Staff
MONTHLY USAGE CHARGE:			
5/8" x ¾" Meter	$32.16	$39.95	$34.00
¾" Meter	32.16	36.95	46.00
1" Meter	62.50	71.81	66.00
1 ½" Meter	82.50	94.79	86.00
2" Meter	96.20	110.53	110.00
3" Meter	180.00	206.81	200.00
4" Meter	285.00	327.45	320.00
6" Meter	600.00	689.37	650.00
Commodity Charge – Per 1,000 Gallons			
5/8" x ¾" Meter (Residential)			
0 to 3,000 gallons	$4.54	$5.75	
3,001 to 9,000 gallons	6.82	8.62	
Over 9,000 gallons	8.19	10.35	
0 to 3,000 gallons			$5.54
3,001 to 10,000 gallons			7.99
Over 10,000 gallons			10.11
5/8" x ¾" Meter (Commercial)			
0 to 9,000 gallons	$6.82		
Over 9,000 gallons	8.19		
0 to 3,000 gallons		$5.75	
3,001 to 9,000 gallons		8.62	
Over 9,000 gallons		10.35	

[76] Ex A-3 Rowell Reb at MJR 13 and Ex S-3 Tsan Dir at PNT-22.

0 to 10,000 gallons			$7.99
Over 10,000 gallons			10.11
¾" Meter (Residential)			
0 to 3,000 gallons	$4.54	$5.75	
3,001 to 9,000 gallons	6.82	8.62	
Over 9,000 gallons	8.19	10.35	
0 to 3,000 gallons			$5.54
3,001 to 10,000 gallons			7.99
Over 10,000 gallons			10.11
¾" Meter (Commercial)			
0 to 9,000 gallons	$6.82		
Over 9,000 gallons	8.19		
0 to 3,000 gallons		$5.75	
3,001 to 9,000 gallons		8.62	
Over 9,000 gallons		10.35	
0 to 10,000 gallons			$7.99
Over 10,000 gallons			10.11
1" Meter (all Classes)			
0 to 18,000 gallons	$6.82		$7.99
Over 18,000 gallons	8.19		10.11
0 to 30,000 gallons		$8.62	
Over 30,000 gallons		10.35	
1 ½ " Meter (all Classes)			
0 to 25,000 gallons			$7.99
Over 25,000 gallons			10.11
0 to 30,000 gallons	$6.82	$8.62	
Over 30,000 gallons	8.19	10.35	
2 " Meter (all Classes)			
0 to 30,000 gallons		$8.62	
Over 30,000 gallons		10.35	
0 to 35,000 gallons	$6.82		$7.99
Over 35,000 gallons	8.19		10.11

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3 " Meter (all Classes)			
0 to 30,000 gallons		$8.62	
Over 30,000 gallons		10.35	
0 to 75,000 gallons			$7.99
Over 75,000 gallons			10.11
0 to 93,000 gallons	$6.82		
Over 93,000 gallons	8.19		
4 " Meter (all Classes)			
0 to 30,000 gallons		$8.62	
Over 30,000 gallons		10.35	
0 to 130,000 gallons			$7.99
Over 130,000 gallons			10.11
0 to 150,000 gallons	$6.82		
Over 150,000 gallons	8.19		
6 " Meter (all Classes)			
0 to 30,000 gallons		$8.62	
Over 30,000 gallons		10.35	
0 to 270,000 gallons			$7.99
Over 270,000 gallons			10.11
0 to 300,000 gallons	$6.82		
Over 300,000 gallons	8.19		

SERVICE CHARGES:

Establishment	$30.00
Establishment (After Hours)	40.00
Reconnection (Delinquent)	30.00
Reconnection (Delinquent) After Hours	30.00
Meter Test (If Correct)	30.00
Deposit	(b)
Deposit Interest	(b)
Reestablishment (Within 12 Months)	(a)
Reestablishment Within 12 months after hours)	(a)
NSF Check	20.00
Deferred Payment (per month)	1.5%
Meter Reread (If Correct)	15.00

Late Payment Penalty (per month)	1.5%		
Moving Customer Meter (customer request)	At Cost		
After Hours Service Charge (at customers request)	N/A	35.00	35.00

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

(b) Per Commission rule A.A.C. R-14-2-403(B).

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 14-2-409D(5).

METER AND SERVICE LINE INSTALLATION CHARGES

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	$450.00	$490.00	$131.00	$621.00	$490.00	$131.00	$621.00
3/4" Meter	475.00	490.00	232.50	722.50	490.00	232.50	722.50
1" Meter	550.00	547.00	293.00	840.00	547.00	293.00	840.00
1-1/2" Meter	775.00	609.50	505.50	1,115.00	609.50	505.50	1,115.00
2" Meter	1,375.00	927.00	1,030.50	1,957.50	927.00	1,030.50	1,957.50
3" Meter	1,975.00	1,171.00	1,661.00	2,832.50	1,171.00	1,661.00	2,832.50
4" Meter	3,040.00	1,661.00	2,646.50	4,307.00	1,661.00	2,646.50	4,307.00
6" Meter	5,675.00	2,478.00	5,025.00	7,504.00	2,478.00	5,025.00	7,504.00

77. In Decision No. 69393, the Commission approved a three-tiered rate structure with tier breaks at 3,000 and 9,000 for customers on 5/8 x ¾ inch and ¾ inch meters and a two tier rate structure with progressively higher tier breaks for the larger meter sizes.

78. The Company states that its proposed rate structure is similar to the current structure in that the "meter multipliers" that relate the monthly usage charge for the larger meters to the 5/8 inch meter charge have not been changed and the ratios of the second and third tier commodity rates to the first tier rate are the same.[77]

79. The Company asserts that applying the standard meter multipliers would substantially increase the bills for customers on the larger meter sizes. The Company further states that because there are very few customers with the larger meter sizes, the extra revenue that would be generated

[77] According to the Company, the meter multipliers used in this case are less than the standard meter multipliers typically in use. Ex A-1 Rowell Dir at 9.

by higher monthly minimums would not be significant, and to increase this revenue source would not meaningfully mitigate the increase for the 5/8 inch or ¾ inch meters.[78] The Company proposed a tier break at 30,000 gallons for all meter sizes 1 inch and larger in order to simplify the rate structure and billing process.[79] The Company argues that because of the "substantial conservation" resulting from the current rate structure, adopting a rate structure that could derive a lower percentage of revenue from the monthly minimum charge or that assigns a greater percentage increase to the higher tier commodity rates than to the lower tiers would be counterproductive.[80]

80. NWC also requests that the new rates be effective at the beginning of the first billing cycle following approval by the Commission rather than on a specific date in order to avoid the greater administrative costs of having to pro-rate bills.[81]

81. Staff's recommended rate design retains the current three-tier structure for the 5/8 x ¾ inch meters and ¾ inch meters, but increases the second tier break to 10,000 gallons (from 9,000 gallons currently). Staff's recommended tier breaks for the larger meter sizes also increase by meter size.

82. The Company proposed new Meter and Service Line Charges, and Staff recommends approving the charges as proposed. In addition, the Company proposes to discontinue the Establishment (After Hours), Re-establishment (within 12 Months After Hours) and the Reconnection (Delinquent-After Hours) charges and to add an After Hours Charge of $35 that would apply to after-hours service provided at the customers' request. Staff agrees with this change.[82]

83. We find that Staff's basic recommended rate design is reasonable. This design does not include three tiers for commercial meters and maintains the scaled tier breaks for the larger meter sizes which maintains an equitable and rational relationship between meter sizes and commodity use. Based on the revenue requirement approved herein, we adopt the following rates and charges:

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[78] Ex A-1 Rowell Dir at 9.

[79] Ex A-1 Rowell Dir at 10. According to the Company, of the 20 bills on the larger meter sizes fall above 30,000 gallons, and of those 20, only one bill would move from the first to second tier, which indicates that the impact on customers of adopting uniform tier breaks for the larger meters is minimal.

[80] Ex A-1 Rowell Dir at 10.

[81] Ex A-1 Rowell Dir at 11.

[82] Ex S-3 Tsan Dir at 18.

MONTHLY USAGE CHARGE:

5/8" x ¾" Meter	$35.00
¾" Meter	48.00
1" Meter	70.00
1 ½" Meter	91.00
2" Meter	116.00
3" Meter	208.00
4" Meter	330.00
6" Meter	664.00

Commodity Charge – Per 1,000 Gallons

5/8" x ¾" Meter (Residential)	
0 to 3,000 gallons	$5.70
3,001 to 10,000 gallons	8.30
Over 10,000 gallons	10.30
5/8" x ¾" Meter (Commercial)	
0 to 10,000 gallons	$8.30
Over 10,000 gallons	10.30
¾" Meter (Residential)	
0 to 3,000 gallons	$5.70
3,001 to 10,000 gallons	8.30
Over 10,000 gallons	$10.30
¾" Meter (Commercial)	
0 to 10,000 gallons	$8.30
Over 10,000 gallons	10.30
1" Meter (all Classes)	
0 to 18,000 gallons	$8.30
Over 18,000 gallons	10.30
1 ½ " Meter (all Classes)	
0 to 25,000 gallons	$8.30
Over 25,000 gallons	10.30
2 " Meter (all Classes)	
0 to 35,000 gallons	$8.30
Over 35,000 gallons	10.30
3 " Meter (all Classes)	
0 to 75,000 gallons	$8.30
Over 75,000 gallons	10.30

4 " Meter (all Classes)

0 to 130,000 gallons	$8.30
Over 130,000 gallons	10.30

6 " Meter (all Classes)

0 to 270,000 gallons	$8.30
Over 270,000 gallons	10.30

SERVICE CHARGES:

Establishment	$30.00
Reconnection (Delinquent)	30.00
Meter Test (If Correct)	30.00
Deposit	(b)
Deposit Interest	(b)
Reestablishment (Within 12 Months)	(a)
NSF Check	20.00
Deferred Payment (per month)	1.5%
Meter Reread (If Correct)	15.00
Late Payment Penalty (per month)	1.5%
Moving Customer Meter (customer request)	At Cost
After Hours Service Charge (at customers request)	35.00

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

(b) Per Commission rule A.A.C. R-14-2-403(B).

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 14-2-409D(5).

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	$490.00	$131.00	$621.00
3/4" Meter	490.00	232.50	722.50
1" Meter	547.00	293.00	840.00
1-1/2" Meter	609.50	505.50	1,115.00
2" Meter	927.00	1,030.50	1,957.50
3" Meter	1,171.00	1,661.00	2,832.50
4" Meter	1,661.00	2,646.50	4,307.00
6" Meter	2,478.00	5,025.00	7,504.00

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84. The rates approved herein would increase the average 5/8 x ¾ inch meter bill, using 4,808 gallons per month, by $9.00, or 15.5 percent, from $58.11 to $67.11.

Other Issues

Water Loss Remediation

85. Staff states that non-account water should be 10 percent or less and never more than 15 percent, and believes it is important to be able to reconcile the difference between the water sold and water produced by the source, as such water balance will allow the water company to identify water and revenue losses due to leakage, theft, and flushing, etc.[83]

86. Decision No. 69393 indicates that in the previous rate case test year, the Township System had a water loss of 23.52 percent; the Bisbee System had a water loss of 31. 39 percent and the Bisbee Highway System had a 4.4 percent loss.[84] The Commission ordered NWC to reduce the water loss to no more than 10 percent before the Company filed its next rate case or submit a detailed cost analysis and explanation demonstrating why water loss reduction to 10 percent or less is not cost effective.[85] On December 12, 2013, NWC filed a "Compliance Regarding Decision 69393" which included a water loss reduction statement/plan, a list of projects funded by WIFA and a hydrology study regarding the sulfate plume.[86] In the water loss report, the Company determined that the water loss was due to aging pipes and service meters, and estimated that a meter replacement program would cost $1,400 per year, and a leak detection program would cost approximately $9,550.[87]

87. Staff states that the calculated water loss for the Township System for the test year was 12.33 percent, which exceeds Staff's recommended 10 percent threshold. Staff recommends that the Company implement its water loss plan (leak detection and meter replacement) immediately and

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[83] Ex S-1 Hains Dir Ex DMH-1 at 8.

[84] Decision 69393 at 14.

[85] Decision No. 69393 ordered NWC to file with its next rate application a statement whether water loss has been reduced to 10 percent or less, and if water loss is still greater than 10 percent for any of its systems, to file with the rate application, a plan to reduce its water loss to 10 percent of less, or if such water loss reduction is not cost-effective, it should provide a detailed cost analysis and explanation why water loss reduction to 10 percent or less is not cost-effective. Decision No. 69393 also required NWC to file a copy of its WIFA loan documents, a list of projects that were funded by the WIFA loan and the hydrology study that it was then performing in order to determine the extent of a sulfate plume and whether it could be attributed to the mining operations of Phelps Dodge.

[86] Filed in Docket Nos. W-02860A-06-0002 and W-02860A-05-0727. NWC filed a copy of the WIFA documents in these Dockets on October 16, 2007.

[87] Ex S-1 Hains Dir Ex DMH-1 at 8. The hearing devoted much time to the cost of installing meters, and how the assumptions concerning the type of meter and how they are replaced can affect the cost of a meter replacement program.

that the Company be required to file water loss reduction progress reports with Docket Control each January and July (covering the prior six months), with the first water loss progress report to be filed in July, 2015.[88]

88. The calculated water loss during the test year for the Bisbee System was negative 15.08 percent, which indicates faulty data. Staff states that based on the Company's 2013 Annual Report, the Bisbee System had a water loss of 3.13 percent, which is within Staff's acceptable limits.[89] Staff recommends that NWC monitor the Bisbee System closely and take action to ensure that the water loss remains below 10 percent, and also recommends that the Company coordinate reading its well meters and individual customer meters on a monthly basis and report this data in its future Annual Reports beginning with the 2014 Annual Report filed in 2015. Staff recommends that if the reported water loss is greater than 10 percent, the Company should prepare a report containing a detailed analysis and plan to reduce water loss to 10 percent or less. Staff states that if the Company believes that it is not cost effective to reduce the water loss to less than 10 percent, it should submit a detailed cost benefit analysis to support its opinion, and that in no case should the Company allow water loss to be greater than 15 percent. Staff recommends that the water loss reduction report or the detailed analysis, whichever is submitted, should be docketed as a compliance item before the Company files its next rate application, and states that Staff may find any future rate case filed by the Company to be insufficient if these items are not properly submitted.

89. NWC disagrees with Staff's recommendations concerning the water loss situation. Ms. O'Connor states that the NWC system is very old and that substantially reducing the water loss even more will be very costly and not save much water.[90] The Company states, however, that if it is provided a revenue stream to pay the costs associated with addressing water loss, it would implement such a program.[91] The Company believes that a leak detection program under which it would hire a third party to survey its system for leaks, would not be cost effective, and argues that replacing old

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[88] *Id.* The calculated water loss for the Bisbee Highway System in the test year was negative 1.81 percent. The Bisbee Highway System was interconnected to the Township System in March 2013. *Id.* at 9.
[89] *Id.*
[90] Ex A-3 O'Connor Reb at 1-2.
[91] *Id.*; Tr. at 35-36 and 39.

meters is the more cost-effective first step in reducing water loss.[92] The Company requested that if the Commission requires a meter replacement program, that it either approve a surcharge for that purpose or allow the Company to replace meters as funds are available.[93] The Company is concerned that if it is required to replace a certain number of meters within a specified period, but cash flow for such purpose is not available because of other needs such as emergency repairs, it will be out of compliance with a Commission Order.[94]

90. The test year water loss for the Township System was 12.33 percent which is significantly better than that in the last rate case and is not alarmingly higher than Staff's recommended 10 percent threshold. In addition, the test year figures represent a period prior to the improvements funded by Freeport McMoRan, and some of them indicate faulty data. While 12 percent water loss is higher than the Commission likes to see, under the current circumstances facing this particular company, we do not find that a Commission-mandated water loss remediation program is warranted at this time. Rather than order NWC to implement a leak detection or meter replacement program, we will require the Company to continue to monitor both systems for water loss and to file an annual water report with monthly water loss calculations. We agree with NWC that at this time, the Company's preferred remediation program of replacing meters is reasonable, and direct the Company to include with its water loss report the number of meters (if any) it replaced during the previous year. In the long-term, replacing aged mains will be necessary, but given the Company's recent cash flow challenges, an extensive capital improvement project at this time may not be practical. At this time, we do not require the Company to replace a certain number of meters per month or year, but if the water loss situation worsens, we may re-evaluate this decision in a future rate case.

91. The Company estimates that if it replaces several meters at the same time, it can replace meters for a cost of between $198 and $275 per meter, depending on the type of meter.[95] At the hearing, there was much discussion about the cost of meters and benefits of various types of

[92] Tr. at 35-40 and 48-54.
[93] *Id.* at 51.
[94] *Id.*
[95] Post-Hearing filing at Exhibit 3.

meters, but at that time, it was not clear that the Company had determined which type of meter it wished to install. The Commission leaves the decision of which meter type to employ to the discretion of the Company's management.

BMPs

92. Staff recommends that NWC 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 five BMPs in the form of tariffs that substantially conform to the templates created by Staff for the Commission's review and consideration. Staff further recommends that the templates created by Staff are available on the Commission's website at http://www.azcc.gov/Divisions/Utilities/forms.asp. Staff recommends that a maximum of two BMPs may come from the "Public Awareness/Public Relations" or "Education and Training" categories, and that NWC may request cost recovery of the actual costs associated with the BMPs implemented in its next general rate application.[96]

93. The Company opposed the recommendation to implement BMPs, and believes that current Commission policy no longer requires companies to adopt BMPs.[97]

94. BMPs are a creation of ADWR and NWC is not required to adopt BMPs under ADWR rules. Recent Commission Decisions have opted not to adopt BMPs for companies that have objected to their imposition. In this case, we do not require NWC to file BMP tariffs, but encourage NWC to find cost effective ways to assist its customers to conserve water, and to propose new tariffs in its next rate case if it believes such tariffs would be beneficial to the Company and its ratepayers. Having Commission approved tariffs would allow the Company to seek recovery of their associated costs in a future rate case.

Hydrology Study

95. Staff requested that the Company docket any hydrology study or engineering evaluation relevant to Well No. 4, but did not elaborate on Staff's use of such reports, and it is not clear if this is a formal recommendation by Staff. While we do not adopt a formal compliance requirement for this issue, we do believe that keeping Staff informed of Company actions taken with

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[96] Ex S-1 Hains Dir at DMH-1 at 16.
[97] Ex A-3 O'Connor Reb at 2.

respect to Well No. 4 will ease any future process that might require Commission action. To this end, we request that the Company keep Staff informed with any decisions that affect production capacity or water quality at Well No. 4. The best way to keep Staff informed is to file with Docket Control any such reports or studies in this Docket.

NARUC USoA

96. During its audit, Staff found that it was necessary to reclassify a number of assets and expenses to conform to NARUC USoA.[98] Staff states that it is a policy in Arizona that utilities keep their books and records in conformance with NARUC's Guidelines and that by doing so, future rate case audits will be made easier. The Company does not to object to using NARUC accounting, but disagrees with Staff's interpretation of certain requirements. We already discussed our decision concerning the use of subaccounts and the use of the office expense account. The Company should ensure that its bookkeepers are familiar with NARUC accounts and classifications and should keep its books and records in accordance with NARUC, Commission Rules, and with the findings of this Order, however, we do not require a compliance filing at this time.

CONCLUSIONS OF LAW

1. NWC 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 NWC and the subject matter of the application.

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

4. NWC's test year FVRB is $1,394,622, and a fair value rate-of-return of 6.1 percent is fair and reasonable under the circumstances of this proceeding.

5. Under the circumstances discussed herein, the rates, charges and conditions of service authorized herein are just and reasonable.

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[98] Tr. at 229.

ORDER

IT IS THEREFORE ORDERED that Naco Water Company, LLC shall file with Docket Control, as a compliance item in this docket, by January 30, 2015, revised rate schedules that comply with the rates and charges approved herein.

IT IS FURTHER ORDERED that the authorized rates and charges shall be effective for all service provided on and after the first billing cycle that commences after February 1, 2015.

IT IS FURTHER ORDERED that Naco Water Company, LLC 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.

IT IS FURTHER ORDERED that, in addition to the collection of its regular rates and charges, Naco Water Company, LLC 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 Naco Water Company, LLC shall monitor its water systems and submit the monthly gallons pumped and sold to determine the non-account water for the year, including information on the number of meters replaced during the year, or other remedial actions taken, and shall annually docket a report of the results of its monitoring as a compliance item in this docket with the first such report due 13 months after the effective date of this Order. If the reported water loss is greater than 10 percent, Naco Water Company, LLC shall prepare a report containing a detailed analysis and plan to reduce water loss to 10 percent or less. If Naco Water Company, LLC believes it is not cost effective to reduce the water loss to less than 10 percent, it should submit a detailed cost/benefit analysis to support its opinion. The first water loss reduction report or the detailed analysis, whichever is submitted, shall be docketed as a compliance item in this docket within 13 months of the effective date of this Order, and filed annually thereafter until further order of the Commission.

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IT IS FURTHER ORDERED that Naco Water Company LLC shall maintain its books and records in accordance with the findings in this Order.

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 __________________ 2015.

JODI JERICH
EXECUTIVE DIRECTOR

DISSENT ________________________

DISSENT ________________________
JR:tv

SERVICE LIST FOR: NACO WATER COMPANY, LLC

DOCKET NO.: W-02860A-13-0399

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