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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

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IN THE MATTER OF THE APPLICATION OF RED ROCK UTILITIES, LLC, AN ARIZONA LIMITED LIABILITY COMPANY, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS WATER AND WASTEWATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.

DOCKET NO. WS-04245A-14-0295

Arizona Corporation Commission
DOCKETED
MAY 20 2015

STAFF'S OPENING BRIEF

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") hereby files its brief.

I. BACKGROUND.

Red Rock Utilities, LLC ("Red Rock" or "Company") is a Class C utility engaged in the business of providing water and wastewater service in portions of Pinal County, Arizona. Red Rock provided water service to approximately 586 customers and wastewater service to approximately 619 customers during the test year. The current rates for Red Rock's water and wastewater divisions were approved in Decision No. 67409, dated November 2, 2004. Because the growth in Red Rock's service territory was slower than was anticipated at the time Decision No. 67409 was issued, Red Rock requested two separate extensions of the due date for filing the rate application ordered by Decision No. 67409. The Commission granted each of those requests the Commission in Decision Nos. 71499 and 73343, respectively. The due date for filing the rate application was extended to August 3, 2012 and August 3, 2014, respectively.

In its application, Red Rock Water proposed a $14,480, or 2.72 percent revenue increase from $533,046 to $547,525.[1] The proposed revenue increase would produce an operating income of 130,934 for a 9.50 percent rate of return ("ROR") on an original cost rate base ("OCRB") of $1,378,255.[2]

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[1] Bourassa Direct Test., Ex. RRU-5 at 3.

Red Rock Wastewater proposed a $356,957, or 74.75 percent revenue increase from $477,549 to $834,505.[3] The proposed revenue increase would produce an operating income of $88,950 for a 9.50 percent ROR on an OCRB of $936,312.[4]

In its application, the Company made several pro forma adjustments to reflect revenue and related expense from customer growth that Staff determined was unlikely to occur and which were not known and measurable. The Company also requested to forego the recovery of income tax expense. Additionally, the Company proposed that the depreciation expense on its excess capacity plant be deferred until its next rate case.

Staff testified that the revenue requirement proposals advocated by the Red Rock did not position the Company to earn its authorized ROR on its rate base, as it suggests in its discussion of the reasons for docketing this rate application.[5] Specifically, the Company's pro forma income statement presented on the C-1 Schedules of the Company's application suggested that with the increase requested the Company would actually be positioned to achieve a positive level of "Net Profit." However, the development of these positive net margins resulted after giving consideration to very large revenue imputations from non-existent customers and from extremely large depreciation expense deferrals. Staff determined that it was more appropriate to address the issue of the magnitude of the Company's revenue increase through the ROR, given the circumstances of this case rather than by making the inappropriate pro forma adjustments and an accounting request proposed by the Company.

Partly in response to the Company's application and the magnitude of the revenue increase, Staff developed two different revenue requirements.[6] Under Plan A, the revenue requirement was developed to recover only the Staff recommended operating expenses resulting in no operating income (i.e., break-even). Under Plan B, the revenue requirement was developed using the Staff recommended rate base, revenue, and expense adjustments and provides a 9.5 percent ROR on the

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[2] *Id.*
[3] *Id.*
[4] *Id.*
[5] Brown Direct Test., Ex. S-4 at 5.
[6] Brown Direct Test., Ex. S-4 at 6.

Staff recommended OCRB. Staff's cost of capital analysis resulted in a ROR of 9.4 percent. However, in order to minimize differences between the parties, Staff adopted the Company proposed ROR of 9.5 percent.[7] Staff also recommended that the Company file seven best management practices and the Company agreed.[8]

The Company in its Rebuttal, accepted Staff's Plan A revenue requirement, but renewed its request for an accounting order to defer depreciation expense associated with plant that has been deemed to be excess capacity.[9]

II. STAFF RECOMMENDS DENIAL OF THE COMPANY'S REQUEST FOR AN ACCOUNTING ORDER.

An accounting order is a ratemaking mechanism that allows the deferral of costs and/or savings by a regulated utility for possible future recovery or credit.[10] The purpose of an accounting order is to grant a utility authority to record transactions differently than otherwise allowed by the Commission-prescribed National Association of Regulatory Utility Commissioners' Uniform System of Accounts.[11]

The Company seeks Commission approval of the annual deferral of approximately $212,000 in depreciation expense.[12] Of this amount, $23,544 is attributable to excess capacity on the Company's water division plant and $188,644 is attributable to excess capacity on the Company's wastewater division assets.[13]

By approving this request, the Company would be allowed to record this level of depreciation expense as a regulatory asset or regulatory accounts receivable recoverable from customers through rates in a future period rather than recording this as a current operating expense on the Company's books and records.

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[7] *Id.* at 26.
[8] Hains Direct Test., Ex. S-2, Engineering Report (Water) at 15-16.
[9] Bourassa Rebuttal Test., Ex. RRU-6 at 2; Weinberg Rebuttal Test., Ex. RRU-3 at 5.
[10] Decision No. 74911 at 7.
[11] Decision No. 71592 at 4.
[12] Bourassa Rejoinder Test., Ex. RRU-7, Exhibit TJB-RJ-1.
[13] *Id.*

According to the Company, the projected per customer impact on water rates is $1.00 and the per customer impact on wastewater rates in $7.99 using a 10 year recovery period.[14] These would be equivalent to a 2.7 percent increase over the average 5/8x3/4 residential water bill under the proposed water rates in the instant case, and an 8.8 percent increase over the average 5/8x3/4 residential wastewater bill under the proposed wastewater rates in the instant case.[15] Staff believes that the total impact may be more.

One of the problems that Staff notes with the Company's projection of the impact on the deferral request is the projection of customer growth. The Company has admitted that its growth projection is "aggressive".[16] In its calculations, the Company projected customer growth of 80 customers; the Company's annual Report for 2014, revealed a growth of only 42 customers. Should the growth be less than the 80 customers projected by the Company, the potential impact to customers would be higher.

The Company also assumes that there would be no excess capacity. Looking at the Company's wastewater division, based on the Company's 2014 Annual Report, Red Rock treated, on average, 115 gallons per day per capita in the Wastewater Treatment Facility ("WWTF"). Based on the annual customer counts reported in the Annual Report from 2005-2014, the projected growth rate is, on average, 34 additional customers per year.[17] By 2019, the projected number of customers would 859. The projected average daily wastewater flow is 98,785 gallons per day. The Company has testified that the WWTF is designed to treat .3 MGD.[18] The Company would need more than the growth it has projected before it would reach capacity, still leaving the WWTF with excess capacity.

The Company's projections also assume of rate of return of 10 percent;[19] however the agreed upon rate of return in this case is 9.5 percent. And finally, Staff is concerned that the projected impact may not encompass the complete total. For example, in the footnote, the Company tries to estimate the costs that current customers are avoiding by the adjustments made to rate base and

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[14] Bourassa Rejoinder Test., Ex. RRU-7 at 5; Ex. TJB-RJ-1.
[15] *Id.*
[16] Tr. at 87.
[17] Ex. S-1.
[18] Weinberg Direct Test., Ex. RRU-2 at ; Tr. at 25.
[19] Tr. at 94.

operating expenses by removing the depreciation expense. But the current customers would not be paying those costs, because there is excess capacity.[20] By adding the numbers in the footnotes, the customer impact is more than $8.99 (water plus sewer), but in the range of $11 to $12.[21]

The Company has not demonstrated the need for an accounting order nor the benefits to its ratepayers. Where the Commission has granted an accounting order, the Commission has identified a benefit to the ratepayers. A review of several Commission decisions where accounting orders have been granted, reveal instances where the plant associated with the request was providing some ratepayer benefit. In this case, there is no benefit to the ratepayer to defer depreciation expense on plant that is not being used to provide service to customers.

In the Matter of the Application of UNS Electric, Inc., UNS Electric ("UNSE") requested an accounting order authorizing the deferral for future recovery of non-fuel costs associated with the UNSE's prospective purchase of up to a 25 percent interest in Unit 3 at the Gila River Power Plant. UNSE had the opportunity to acquire up to a 25 percent interest in the Gila River Power Plant Unit 3 ("Gila River Unit 3"), which is a combined-cycle natural gas fired power plant. According to UNSE, Gila River Power Plant consists of four "power blocks" with each block representing 550 MW of nominal capacity. UNSE stated that Gila River Unit 3 provided the Company with a unique opportunity to address its need for base load generation at a reasonable price. Because UNSE's share of the purchase price of Gila River Unit 3 was a substantial investment relative to its current rate base, UNSE sought an order that would allow the deferral for future recovery of the non-fuel costs of maintaining and operating the plant.

In granting the UNSE request for an accounting order, the Commission noted that there was a benefit to both UNSE and its ratepayers by providing an efficient and economical source of baseline power.[22]

In The Matter Of The Application Of Arizona Public Service Company For Authorization For The Purchase Of Generating Assets From Southern California Edison And For An Accounting

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[20] Tr. at 89-90.
[21] See Bourassa Rejoinder Test., Ex. RRU-7, Exhibit TJB-RJ-1; Tr. at 95.
[22] Decision No. 74911 at 7.

Order, Arizona Public Service ("APS") requested a waiver of the self-build moratorium and also requested an accounting order to: 1) authorize the APS to defer for future recovery certain costs relating to the transaction; and 2) provide assurance that APS may continue to recover the capital carrying costs, depreciation, decommissioning, mine reclamation, and other obligations that may arise with respect to Four Corners Units 1 – 3.[23] APS noted that there would be significant cost savings for its ratepayers. In granting an accounting order for the deferral of non-fuel costs, the Commission noted that there would be cost savings to the ratepayers.[24]

The Company cites *Goodman Water* as persuasive.[25] However, as the Company acknowledged, the Commission adopted a settlement agreement between the majority of the parties in that case. Staff was not a signatory.

Red Rock has not quantified any customer savings or benefit, only that deferring depreciation expense on excess capacity would minimize the Company's annual losses and reduce erosion of the Company's equity balance, thus leading to greater financial stability.[26] The Company's request would require captive customers to subsidize the owner's loss. It is the Company, not the ratepayers that should bear the risk for the plant that is designated as excess capacity that is not used and useful. Customers should only be required to pay the actual and reasonable cost for plant that is needed to provide service. The Commission should deny the request for an accounting order.

III. OTHER ISSUES.

During the hearing, the Administrative Law Judge requested further details regarding an adjustment made by Staff to Account No. 302, Franchise Costs.[27] Staff had removed $5,904. The adjustment made by Staff reflects amounts for consulting and legal fees that were not associated with the provision of service to Red Rock customers.

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[23] Decision No. 73130 at 7.
[24] *Id.* at 36.
[25] Bourassa Rejoinder Test., Ex. RRU-7 at 8.
[26] Bourassa Direct Test., Ex. RRU-5 at 7.
[27] Brown Direct Test., Ex. S-4, Schedule CSB-5 (water).

IV. CONCLUSION.

The proposed accounting order would change the ratemaking dynamic by allowing the Company to recover depreciation expense on plant that is not being used to serve its customers, no matter how well intentioned the building of plant was by the Company. Staff recommends the denial of the Company's request.

RESPECTFULLY SUBMITTED this 20th day of May, 2015.

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