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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF UTILITY SOURCE, LLC, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANTS AND PROPERTY AND FOR INCREASES IN ITS WATER AND WASTEWATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO: WS-04235A-13-0331 **POST-HEARING BRIEF**

Utility Source, L.L.C. ("Company" or "Utility Source"), hereby files its post-hearing brief ("Brief"). This Brief hereby incorporates the Company's Final Schedules filed with the Arizona Corporation Commission ("Commission") on March 6, 2015.

This Brief begins by addressing issues related to the wastewater rate case component. Next, the Company addresses issues related to the water rates. Finally, the Company discusses the cost of capital issues.

1.0 WASTEWATER

The Company and Staff have very similar proposals. The Company and Staff agree upon the rate base and operating expenses mostly. The Company's proposed revenue requirement is $318,237. Staff's proposed revenue requirement is $305,275. The variances are due to differences in proposed rate of return and "flow through" items such as taxes based upon proposed revenues. The court should follow this approach and adopt the Company's proposed rate base, operating expenses, and rate of return related to wastewater service. Furthermore, the Court should adopt the Company's rate design because it offers both financial stability and has a reasonable chance to actually meet the revenue requirement.

1.1 Rate Base

If the law and standard rate-making procedures are followed, then the rate base for the wastewater division should be $825,880. Staff and the Company agree on this amount. The Company believed it was settling the issue when it agreed with Staff's adjustments, which RUCO mostly followed as well earlier in the proceeding.

Staff and the Company arrive at this same amount because they started from the same rightful point - Decision No. 70140. In this decision, the Commission established a rate base and found CIAC in the amount of $197,973. *See id.* at p. 9. This finding was based upon the recommendation of then-Staff witness Michlik. The Company respected the previous Commission decision and made no changes to CIAC. *See* Bourassa's Final Schedule B-1. The numbers were just carried forward from the last rate case. Staff has done the same and used the CIAC balance approved in the prior rate case. Keller Testimony at p. 759, line 16 – 18; *see* also Staff Final Schedule JLK-WW4, line 32.

Not only is respecting previous decisions standard practice before the Commission, it is the law. A.R.S. § 40-252 states, "[I]n all collateral actions or proceedings, the orders and decisions of the commission which have become final shall be conclusive." A collateral attack is an effort to obtain a judgment that defeats the first judgment. *See Cox v. Mackenzie*, 70 Ariz. 308, 219 P.2d 1048, 1051 (1950).

In direct conflict with this law, Nielsen and RUCO have taken the position that this court should make decisions about rate base that the Commission decided in the last rate case. For the first time in its final schedules, RUCO makes a $109,206 adjustment of "additional unrecorded CIAC". *See* Final Schedule JMM-7. RUCO also makes a "hook-up fees unrecorded" adjustment of $361,800. *See* Final Schedule JMM-7. Nielsen seems to make this same assertion in his filing dated March 10, 2015. *See id.* at p. 2-3. As the Company has noted from the onset, the Commission's decision on how to treat then-existing plant decided in Decision No. 70140 are conclusive and cannot be undone now by collateral attack.

Moreover, neither RUCO nor Nielsen provided any credible evidence that the Commission made the wrong decision in the last rate case. For example, RUCO cites the testimony of its witness Michlik as authority for claiming that the Commission-approved rate base still includes $361,800 in hook-up fees that should be deducted from rate base and treated as CIAC. *See* Final Schedule JMM-7 (References column B – testimony of JMM). RUCO cites Michlik's testimony for the proposition that there is additional unrecorded CIAC in the amount of $109,206. But nowhere does he ever make such claim. In fact, just the opposite is true. In the previous rate case, Michlik was the Commission staff person who analyzed the Company financials and recommended the rate base the Commission adopted. Put another way, Michlik is now effectively avowing that seven years ago, after thoroughly reviewing the plant then at issue, he made a $461,006 mistake by overlooking $361,800 in hook-up fees and missing $109,206 in contributed plant. With all due respect, how can this court give Michlik's testimony offered now more weight that the testimony and recommendation he offered to the Commission seven years ago when he was responsible for ensuring the rate base included only proven costs?

Similarly, Nielsen's position is not based upon facts; it is conjecture. Nielsen simply speculates that there is "additional unrecorded CIAC" in the rate base the Commission adopted in the last rate case. He also speculates that the Company received $361,800 in "unrecorded hook-up fees", but there is no proof supporting these accusations.

1.1.1 Land Rights

Nielsen also challenges the Commission's determination of the value of the land used to provide sewer service. In the prior rate case decision, the Commission established a rate base and found the land value to be $105,000. This finding was based upon the recommendation of then-Staff witness Michlik. Again, the Company made no changes to CIAC. *See* Bourassa's Final Schedule B-1. The land value was just carried forward from the last rate case. Staff did the same. Keller at p. 759, line 16 – 18; *see* also Staff Final Schedule JLK-WW4, line 32.

But Nielsen mistakenly believes that the Commission's earlier decisions can be attacked in this case. Though no changes have occurred, Nielsen believes the Company's original land value cost should be reduced by $30,476.80. See Nielsen's Notice of Filing, p. 2-3 (Mar. 10, 2015). This is simply wrong.

1.1.2 Small Treatment Plant Is Used and Useful

The Company, Staff, and RUCO all agree that the small treatment plant, which is used to hold and treat sludge, should remain part of rate base. This is based upon a determination by Staff's engineer that the plant is currently used and useful as a sludge storage facility. *See* Thompson testimony at p. 555, lines 20-21. Meanwhile, Nielsen believes this plant is not useful because it is not being used as influent treatment. Despite Nielsen's position, using the plant to continue the process of decomposing and drying the sludge before shipping it to a landfill is extremely useful and saves the customers thousands of dollars in sludge hauling fees each year. Therefore, the Company's position should be adopted.

1.2 Operating Expenses

Staff made the following material adjustments: (1) reduced purchased power by $207; (2) increased water testing by $8,858; (3) reclassified $3,484 of SRP bill payment to rent; (4) reduced auto expense by $1,750; (5) reduced telephone expense by $2,366; and (6) removed $7,145 from miscellaneous expense, reclassifying some to rent. Staff also proposed $10,000 in rate case expense. The Company has agreed to these adjustments.

Meanwhile, following Nielsen's lead mostly, RUCO has proposed several drastic adjustments. Initially RUCO proposed the following: (1) no rate case expense [recovered in a surcharge]; (2) reducing automobile expense by $1,750; (3) reducing telephone expense by $2,366; (4) reducing purchased power by $413; and (5) reducing accounting services by $8,126. After the hearing RUCO proposed the following adjustments (6) reducing telephone expense by an additional $1,536; (7) reducing copier expense by $1,922; (8) reducing the SRP in-lieu rent by $6,020; (10) reducing auto expense another $708; and (9) reducing Staples office supplies another $298.

Nielsen has taken the positions primarily upon the mistaken belief that Utility Source is sharing office and employees with other companies. However, unrefuted testimony is that the Company does not share office space. Testimony of McCleve, p. 38, lines 11-12. Admittedly, the Company does allow others like the HOA to use the conference room on occasion, but this is a courtesy, not an office sharing arrangement. *Id.* at p. 38, lines 13-25. Likewise, the testimony establishes that Mrs. Parry works for Utility Source, and while she does help people on tasks unrelated to her Utility Source tasks, her primary job is working for the Company. *Id.* at p. 39, lines 1-17. *See* also p. 74, lines 1-16. Based upon the fact that Utility Source does not share employees or office space, the proposed adjustments by Nielsen should not be followed.

1.3 Rate Design

The Company's rate design is patterned after the rate design in the previous rate case and should be adopted. The Company has 320 residential customers and 4 commercial customers. Therefore, the Company understands the residential rate design is critical. Therefore, for the typical residential customer, the Company proposes a $52.00 minimum and $4.96 per 1,000 gallons of water use per month. This will provide the Company revenue stability and retain the link to water use as Staff has historically wanted.

Curiously, Staff is recommending a $50.00 minimum and no commodity charge. Here, the concern is that Staff is piling way too much of the rate increase upon the 4 commercial customers. Under Staff's proposal, commercial customers will pay $11.61 per 1,000 gallons of water purchased. It stands to reason that such a high commodity rate will cause water conservation to occur. While water conservation is a sound public policy, here it can leave the Company without sufficient revenues.

On the other hand, RUCO is proposing a rate design without a monthly minimum. The Company's current rate design does not have a monthly minimum either. This has left the Company in financial trouble during the Winter months when water use drops dramatically. This approach unduly exposes the Company to undue risk when conservation occurs. There is no doubt that with the new water and wastewater rates, conservation will occur, so the rate design needs to ensure that the Company has some revenue stability. Thus, the Company's middle-ground approach of a monthly minimum and commodity charge is the best rate design.

2.0 WATER

The Company's proposed rates follow common practices and procedures, with one major exception. To soften the rate impact to its customers, Utility Source removed the value of Deep Well 4, which is approximately $1.5 million, from rate base. With this adjustment, the rate case should have gone forward pursuant to standard rate-making methods. Instead, at the eve of trial Staff came up with a proposal to try and capture revenues from a standpipe constructed one year and eight months after the test year. Defying rate-making standards and logic, Staff creates mismatches by allocating costs and expenses in the 2012 test year to the standpipe that began operating in late 2014. Meanwhile, the intervenors are trying to collaterally attack the rate base adopted by the Commission seven years ago. In light of these positions, the Company is the only party offering a reasonable proposal.

2.1 Standpipe Operation

First and foremost, the Company's position on the standpipe operation is clear. The test year is 2012. The standpipe began operating in September 2014. The Company did not include any revenues, investments or expenses related to the standpipe. In other words, the Company's position is that the standpipe operations should not affect the rate case. *See* Bourassa Testimony of p. 145, line – p. 146, line 19. Neither the post-test year plant nor the revenues derived from that plant should be included in this case. All of the operating expenses and plant that was used and useful during the test year are rightfully allocated under the Company's proposal.

But Staff's proposal is creating a classic mismatch. Staff wants to add the anticipated revenues (which are nothing more than estimates) gained from the standpipe operation into the rate case. Incredibly, Staff is proposing to remove 25% of the mains, 50% of the rate case expense, and 25% of other expenses from the test year and allocate those expenses to the projected standpipe customers.

Meanwhile, to his credit, Staff's engineer held his professional opinion and testified that Deep Well 4 is needed to produce water for the standpipe and redundancy. *See* Thompson Testimony at p. 549, lines 4 – 9. Yet, Staff did not include the Deep Well 4 cost of $1,500,000 in rate base. Similarly, Staff did not include the $165,000 of investment in the standpipe loading facility either. *See* Staff's Final Schedules at Schedule JLK-W4 (water). In other words, Staff's position is that the revenue from the standpipe should be counted, but the investment needed to generate that revenue should be ignored.

When considering post-test year plant, typically RUCO and Staff take the positions that the plant should be (1) used and useful within 6 months of the test year, (2) revenue neutral [for existing customers], and (3) the cost must be known and measurable. *See* Michlik Testimony at p. 441, line 19 – p. 443, line 1. Known and measurable changes are changes in a company's assets and operations that occur after the end of a test year but before rates are set, and that are shown to be reliable and certain. *See Utah Power & Light Co. v. Idaho Public Utils. Comm,* 102 Idaho 282, 284, 629 P.2d 678, 680 (1981). Here, none of those elements are met.

Not only is Staff's proposal inconsistent with common practices, it is simply conjecture. Staff is allocating plant used and useful long before the standpipe was built to its "standpipe customer rates." Staff is allocating expenses incurred during 2012 to the standpipe system when such system was not in place at that time and without a cost of service study. Bourassa Testimony at p. 144, lines 5-6. Staff is projecting revenues based off data collected over a few months. Staff's proposal effectively splits Utility Sources' system into two separate systems. This is extremely odd, violates normal procedures and is clearly not proper rate making.

The Company's position is undeniable and clear - if the revenues of the standpipe are going to be included in the rate base, then the investments of $1.5 million in Deep Well 4 and $165,000 in standpipe station construction must also be included in rates. *See* Bourassa Testimony at p. 145.

Finally, the Company is aware that Staff and the intervenors were concerned that the Company might over earn. Therefore, the Company proposed that if its revenues exceeded the revenue requirement by 10%, then the Company would file another rate case.

2.2 Rate Base

The Company's position is clear and consistent with the law and common practice at the Commission. The Company proposes a rate base of $1,499,779. This recognizes that the Company received $294,745 in CIAC, which was carried forward from Decision No. 70140. Importantly, at the outset of the rate case, to ease the burden on its customers the Company voluntarily removed Deep Well 4 and its related improvements from consideration, which amounted to a $1,488,899 reduction in rate base. During the rate case discovery process, Utility Source agreed with Staff's adjustment removing $5,885 in deposits from rate base. Before its decision to grab the standpipe revenues, the Company and Staff had consistent proposals.

2.2.1 Land Rights and Plant

The Company does agree with all of the parties that the $92,000 adjustment to remove shallow wells 1 and 3 from rate base. But there are still issues to be addressed, unfortunately. As he does with the wastewater plant, Nielsen challenges the Commission's determination of the value of the land used to provide water service. In the prior rate case decision, the Commission established a rate base and found the land value to be $210,000. Again, the Company made no changes; the land value was simply carried forward. *See* Bourassa's Final Schedule B-2 (water). Nielsen also asserts the fire hydrants and some of the water distribution system were CIAC. However, there is no evidence to support this assertion. Again, the Company simply carried the rate base forward. Nielsen also claims the Company was given $201,000 in hookup fees by developers and that amount should be deducted from the rate base set in Decision No. 70140. But as the Company has repeatedly explained to Nielsen, the purpose of this rate case is not to relitigate issues decided seven years ago. Making the adjustments proposed by Nielsen would be an improper collateral attack on a previous Commission decision. *See* Cox v. Mackenzie, 70 Ariz. 308, 219 P.2d 1048, 1051 (1950).

2.3 Operating Expenses

The Company accepted Staff's previous adjustments to operating expenses. The Company continues to support its operating expenses set forth in its final schedules. The Company does not support Staff's across the board 25% reduction to the 2012 operating expenses proposed by Staff. Those expenses were incurred and established in 2012 and it is nonsense to believe those costs are going to go away because the standpipe is now operational.

As explained above in the wastewater section, the adjustments proposed by Nielsen and RUCO are improper. Again, the Company believes rate case expense should be included in rates, not a surcharge. As previously explained, Mrs. Parry works for Utility Source full time; she does not split her time with any other business. The Company disputes the final adjustments proposed by RUCO set forth in RUCO Final Schedule JMM-17 and proposals by Nielsen.

2.4 Fire Flow

As the Company explained, the fire flow issues have been resolved. McCleve Testimony at p. 35, line 18 – p. 36, line 14.

2.5 Rate Design

The Company continues to support its water rate design. *See* Company Final Schedule H-3. These rates offer the Company rate stability while encouraging conservation.

2.6 BMPs

The Company still opposes any requirement to adopt BMPs.

3.0 COST OF CAPITAL

The Company recommends a cost of equity of 11% based on recent analyses. Company expert Bourassa testified that the range of DCF, CAPM, and Build-up Method analyses is 9.0% to 11.6% with a mid-point of 10.3%. A return on equity of 11.0% for Utility Source, given its size and greater risk compared to the public traded water utilities, is conservative. The Company's recommended capital structure consists no debt and 100% common equity. Based on the Company's recommended cost of equity and capital structure, the Company's weighted cost of capital is 11.0%, as shown in Exhibit A-1, Rejoinder Schedule D-1.

The Company's position recognizes the significant business and investment risk facing small utilities like the Company. *See* Bourassa Testimony at p. 156, line 7 – p. 158, line 2. As Bourassa noted, small utility companies often fail to earn their authorized rate of return when compared to large utilities. *Id.* at p. 158, lines 3-11. Therefore, Bourassa recommends a 70 point adjustment to recognize the fact that small utilities face far more risk that large utilities and the Commission should recognize this fact. *See* Bourassa Testimony at p. 782, line 8 – p. 783, line 13.

Staff and RUCO, however, purport to treat small utilities like a large company or worse. As everyone knows, unlike a large company, a small company cannot sell bonds and there is no dispute that banks typically do not loan money to small water companies in Arizona. *See, e.g.,* Mease Testimony a p. 506, line 11 – p. 507, line 16; Cassidy Testimony at p. 601, line 6 – p. 602, line 15. Further, small water companies, like Utility Source, do not have access to the publicly traded equity markets. This means it is extremely difficult for small water companies to raise capital, which increases risk. More importantly, large utility market returns for the last 1-year, 3-year, and 5-year periods range from approximately 12.6% to 11.8%. Bourassa Testimony at p. 784, lines 19-23. These large company returns are much higher than those proposed by Staff and RUCO.

What is equally striking is that not only are Staff's and RUCO's cost of capital recommendations far below the returns of large companies, but both actually had to make substantial adjustments to their models to raise their recommendations because the results from their models were far too low. Staff is recommending a cost of capital of 9.8%. However, Staff's models produced such a low number that Staff added an "economic assessment adjustment" of 60 basis points to reach that number. *See* Cassidy Testimony at p. 614, line 24 – p. 615, line 18. Similarly, RUCO's proposed cost of capital of 9.25% includes a 70 point upward adjustment. Again, this is because the models RUCO used produced a result that was way too low. *See* Mease Testimony at p. 508, line 20 – p. 509, line 16.

Thus, the Company's models produced a 10.3% result that was below the earnings of large companies, and when the Company added 70 basis points, the rate of return was still below, but near the large company earnings. Meanwhile, both Staff and RUCO used models that produced unreasonably low numbers, so they made 60 and 70 basis point adjustments so their recommendations would seem somewhat rational. But despite their efforts, clearly the Company's models are more accurate and its recommendation is the most reasonable.

RESPECTFULLY SUBMITTED on March 24, 2015.

Steve Wene

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