0000161697

RECEIVED

BEFORE THE ARIZONA CORPORATION COMMISSION

2015 APR 17 P 4: 03

AZ CORP COMMISSION
DOCKET CONTROL

SUSAN BITTER SMITH
Chairman

BOB STUMP
Commissioner

BOB BURNS
Commissioner

DOUG LITTLE
Commissioner

TOM FORESEE
Commissioner

Arizona Corporation Commission
DOCKETED
APR 17 2015
DOCKETED BY

ORIGINAL

IN THE MATTER OF THE APPLICATION OF EPCOR WATER ARIZONA, INC. FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BY ITS MOHAVE WATER DISTRICT, PARADISE VALLEY WATER DISTRICT, SUN CITY WATER DISTRICT, TUBAC WATER DISTRICT, AND MOHAVE WASTEWATER DISTRICT

DOCKET NO. ~~SW~~ WS-01303A-14-0010

EPCOR'S POST HEARING OPENING BRIEF

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

On March 10, 2014, EPCOR Water Arizona, Inc. ("EWAZ" or "Company"), which was not earning its authorized return in any of the districts in this case, filed an Application for an adjustment to its existing rates and charges, utilizing a test year ending June 30, 2013. The Commission approved EWAZ's current rates and charges for utility service in Decision No. 71410 (December 8, 2009), using a test year ending December 31, 2007, for the Paradise Valley Water District, Tubac Water District, and Mohave Wastewater District; Decision No. 72047 (January 6, 2011), using a test year ending December 31, 2008, for the Sun City Water District; and Decision No. 73145 (May 1, 2012), using a test year ending June 30, 2010, for the Mohave Water District. For the test year, EWAZ's adjusted, actual rates of return for each of the districts as compared to the authorized rates of return were as follows:[1]

District	Tubac	Mohave Wastewater	Paradise Valley Water	Sun City Water	Mohave Water
Authorized Return	7.33%	7.33%	7.33%	6.7%	7.1%
Actual Return	**(3.72)%**	**1.80%**	**5.94%**	**4.23%**	**2.00%**

EPCOR Water USA, Inc. ("EPCOR") purchased these systems in the first quarter of 2012.[2] Following the closing of this purchase, EPCOR waited two years before bringing its first rate case for any of these districts. Since purchasing the Company, EPCOR, as a responsible owner, has continued to ensure EWAZ's compliance with Arizona Corporation Commission ("Commission" or "ACC") orders, rules and regulations and has continued to provide safe and reliable drinking water and wastewater service to its customers by investing in these systems at substantial and appropriate levels.[3] In doing so, EPCOR has met its obligations under the regulatory compact. Despite this, the Commission Staff and RUCO have recommended in this case, without support, the undoing of certain previously approved amounts in rate base based on a new, unsupported approach to accumulated depreciation. Commission Staff and RUCO have also changed their approach to certain other items, including the recovery of incentive compensation paid by the Company. Although there is no question that Commission policy has evolved and must continue to evolve, the changes proposed by RUCO and Commission Staff do not support the continued investment needed by Arizona water and wastewater utilities or recognize the issues facing utilities now and in the future.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

[1] Company's Schedules at Schedule A-1 (for each district).
[2] *See* Decision No. 72668.
[3] *See* Exhibit ('Ex.") S-1; Ex. A-4.

In its October 14, 2014 filing, the Company sought a revenue increase of $5,276,155.[4] As set forth in its Final Schedules, the Company, after considerable concessions during the pendency of this proceeding, now seeks a total increase in annual revenues of $4,242,376.[5] The Company worked closely with Staff and RUCO in an effort to find common ground on positions taken by the parties. During these discussions, the Company agreed to a reduction of approximately $1 million from the Company's initial request.[6] This included a reasonable reduction to its cost of capital recommendation, as well as the acceptance of Staff's position relating to depreciation expense on certain plant items and a reduction of its request for incentive compensation to eliminate amounts tied to financial performance.[7] The table below summarizes the adjustments made by the Company to resolve differences between the parties:

Revenue Increase Requested with (10.7% ROE)	**$ 5,276,155**
▪ Adjusted ROE to reflect current interest and market trends	$ (94,000)
▪ Accept Staff's Depreciation Expense adjustment	$ (385,000)
▪ Adjust Incentive Compensation consistent with prior Commission Orders	$ (114,000)
▪ Accept Staff's Recommendation for Low Income Program Revenue	$ (91,000)
▪ Movement Toward Staff's Tank Maintenance Recommendation	$ (63,000)
▪ Accept RUCO's Chemicals adjustment & Staff's Power & Misc. Expenses	$ (44,000)
▪ Accept Staff's Adjustment to Deferred Debits	$ (10,000)
▪ Agreement with Staff's and RUCO's State Tax Rate	$ (28,000)
▪ True-up to Actual of 24-Month Deferral of AFUDC and Depreciation	$ (21,000)
▪ Accept RUCO's Recommendation for Asset Reclassifications	$ (95,000)
▪ Accept Staff's Adjustments to O&M Expenses	$ (27,000)
▪ Accept Staff's Recommendation for Deferred Debits (excluding 24-Month Deferral)	$ (5,000)
▪ Accept Staff's and RUCO's Corrections Identified during Hearing	$ (56,000)
Final Revenue Increase Requested with 10.55% ROE	**$ 4,242,376[8]**

[4] Ex. A-1, A-1 Schedules.

[5] EWAZ's final position is set forth in its final schedules filed on April 6, 2015 ("Company's Schedules"). The Commission Staff's final position is set forth in its final schedules filed on April 6, 2015 ("Staff's Schedules"). RUCO also filed its final schedules on April 6, 2015 ("RUCO's Schedules"). No other party filed final schedules.

[6] Ex. A-1, A-1 Schedules.

[7] Ex. A-9.

[8] Ex. A-1; Ex. A-2,;Ex. A-3; Company's Schedules.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

Despite the Company's acceptance of these positions and its willingness to reduce its initial request by nearly $1 million, the parties continue to have substantial differences in relation to the change to the revenue requirement to be authorized in this case. While a great effort was made to find common ground, these variances arise from substantial differences of the parties in relation to cost of capital, accumulated depreciation balances, post-test year plant additions, a 24-month deferral of AFUDC and depreciation expense, and other key issues relating to rate base and operating income. Rate design is also an issue in dispute between the parties--an issue that demands attention given its tendency to drive consumer behavior and increased likelihood to put the Company at further risk of not earning its authorized return.

The Company's position in relation to those issues is discussed in detail below.

I. ACCUMULATED DEPRECIATION

The importance of stable, well-reasoned regulation of Arizona utilities cannot be understated. When EPCOR purchased these systems from American Water, the authorized rate base for each district was included in the determination of the purchase price. Now, despite both RUCO and Staff recommending approval of the majority of these debit balances in prior cases, both Staff and RUCO now seek to undo and completely void these balances without any support.[9] This approach, which could be viewed as retroactive ratemaking and as undermining the authority of prior Commissions, sets a dangerous precedent for future actions by the parties involved. If the Commission is to continue to encourage and to support investment into and by Arizona utilities, this unsupported change in regulation proffered by Staff and RUCO should not be supported.

A. Debit Balances

Debit balances in accumulated depreciation can arise for specific accounts when the original cost of plant being retired is more than the accumulated depreciation recorded in

[9] Ex. A-13 at 3-6; Staff's Schedules; RUCO's Schedules.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

that account. As a result, debit balances increase a company's rate base so that it has the opportunity to earn a return on and of that investment. This approach has been utilized and accepted by the Commission in prior rate cases, but in this case, Commission Staff and RUCO seek to change the Commission's historical approach and eliminate these balances.

As part of the litigation of each rate case, the Company, as required by Commission Staff and RUCO, has supported its starting plant balances with "roll forward" schedules.[10] As Commission Staff explained in its testimony:

> A plant and accumulated depreciation schedule is a schedule that shows the annual plant additions, plant retirements, depreciation accruals, and ending plant and accumulated depreciation balances by year by NARUC account numbers from the end of the test year of the Company's last rate case to the end of the test year of the instant case. The beginning balances to be used in the schedules are the plant and accumulated depreciation balances (by NARUC account number) approved by the Commission in the Company's last rate case.[11]

As agreed by all parties involved, in each case, Commission Staff and RUCO utilize these schedules to perform their audit of the Company's rate case application.[12] Utilizing these schedules, as well as multiple data requests and data responses, both Commission Staff and RUCO, in each case, conduct the following analysis in relation to the Company's plant and accumulated depreciation schedules:

> 1. Verifying that each annual year-end plant balance is mathematically correct (the beginning plant balance plus the plant additions less the plant retirements equals the ending plant balance).
>
> 2. Verifying that the summation of the actual plant additions, retirements, and depreciation accruals for each year equals the actual plant and accumulated depreciation balance reported in the Company's application and general ledger.
>
> 3. Determining whether or not the Company has made the appropriate retirements of plant . . . .
>
> 4. Determining whether or not the plant identified by Staff Engineering as "not used and useful" or otherwise not in service has been reflected in the appropriate year and the appropriate plant account.

[10] Transcript ("Tr.") at 1082.

[11] Ex. S-14 at 9.

[12] Tr. at 408-11 (Michlik); 487-88 (Coley); 841 (Rimback).

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

5. Verifying that the depreciation expense for each year and for each plant account was calculated correctly using the correct plant balance and the correct depreciation rate.
6. Determining whether or not any plant accounts have been over-depreciated.[13]

Following this analysis, Commission Staff and RUCO put forth their positions in pre-filed testimony, defended this pre-filed testimony during the hearings, and ultimately, submitted their final positions in Final Schedules. As shown at length during the Company's rebuttal case, the vast majority of these prior balances were litigated in prior cases.[14] In these prior cases, the Company, as required, provided the details of the balances existing for the period from the previous rate case's test year through the test year end of the rate case filing by using roll forwards of the plant and accumulated depreciation balances.[15] Following submission of those schedules by the Company, Commission Staff and RUCO performed their respective investigations, including serving discovery requests on the Company, and submitted their own schedules as part of their pre-filed testimony.[16] Then, following the evidentiary hearing and testimony, Commission Staff and RUCO submitted final schedules.[17] Although RUCO and Commission Staff now claim, without proof, that these balances are "improper" or "abnormal", this claim contradicts their own positions in prior cases.[18] And, in this case, following extensive discovery and consultation, both RUCO and Commission Staff came to agreement with the Company as to the initial plant balances to be used in this case, which resulted in the Company's October 14, 2014 filing.[19]

[13] Ex. S-14 at 9-10; Tr. at 408-11 (Michlik); 487-88 (Coley); 841 (Rimback).
[14] Exs. A-41; A-42; A-43; A-44; A-45; A-47; A-49; A-52; A-53; A-56.
[15] Tr. at 410-11, 1082; Exs. A-41; A-43; A-49; A-52.
[16] *See, e.g.,* Exs. A-42; A-47; A-53.
[17] Exs. A-42; A-44; A-45; A-47; A-50; A-53.
[18] Tr. at 1082
[19] Ex. A-1; Tr. at 492, 850, 1083.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

1. The Company Has Kept Its Accounts in Accordance with the NARUC USOA

In accordance with the NARUC Uniform System of Accounts ("NARUC USOA"), proper accounting for plant retirements requires that a utility credit utility plant in service ("UPIS") and debit accumulated depreciation with the original cost of the retired asset.[20] If an asset is retired before the average service life set by the Commission to establish its depreciation rate, the accumulated depreciation recorded on the Company's books for the asset is less than the original cost.[21] Accordingly, the net effect of such a retirement (or group of retirements) is a debit balance for that asset account if the total accumulated depreciation is less than the original cost of the retired asset.[22] As explained by Mr. Guastella in his testimony, this result "is not only common but expected."[23] These debit balances represent "an under-recovery or shortfall in the recovery of the original cost of the assets."[24] There can be no dispute by either Commission Staff or RUCO that this accounting approach is required by the NARUC USOA, which the Commission has incorporated into its own rules.[25]

The example set forth in Exhibit A demonstrates in simple terms how debit balances can arise. As set forth in the example, two assets are placed in service in the same plant account which has a depreciation rate of 10%. The first asset is placed in service in 2009 at a cost of $180. The second asset is placed in service in 2012 at a cost of $200. The first asset is then retired early after six years in 2014. Consistent with the NARUC USOA, the asset is retired at its original cost of $180, which causes the accumulated depreciation in that account to change from a credit balance to a debit balance (in 2014, the accumulated depreciation balance was a credit balance of $150, before the

---

[20] Ex. A-13 at 2; NARUC Uniform System of Accounts for Class A Water Utilities ("NARUC USOA") at 56 (1996). Excerpts from the NARUC USOA, which is incorporated into the Commission's rules, are attached as Exhibit B.
[21] Ex. A-13 at 2.
[22] *Id.* at 2-3.
[23] *Id.* at 3.
[24] *Id.*
[25] AAC R14-2-411.D.2; AAC R14-2-610.D.2; NARUC USOA at 56; Tr. at 851.

retirement). Over time, the debit balance reverts to a credit balance as depreciation expense continues to accumulate on the remaining assets in that account. Under the example, the first asset had a life of six years (*i.e.,* less than the 10-year average service life), while the second asset had a life of 14 years (*i.e.*, more than the 10-year average service life). However, the cost of both assets is recovered after 20 years for an average of 10 years for this group of assets.

The retirement of an asset earlier than its average service life is a common occurrence for groups of assets, creating an undepreciated balance for that asset.[26] The debit balance simply means that the total original cost of the asset was not recovered through depreciation accruals because of the early retirement.[27] Accordingly, the debit balances in accumulated depreciation are, in fact, undepreciated balances or unrecovered costs, not "Phantom Assets" as Commission Staff and RUCO suggest.[28]

The acceptance by the Commission of RUCO's and Commission Staff's proposal to simply remove the debit balances from accumulated depreciation, and thereby reduce rate base by the undepreciated portion of the cost of the retired assets, would result in a failure to recognize the net investment on which a return should be allowed and would be contrary to the NARUC USOA plant accounting instructions and applicable law.[29]

2. The Commission's Prior Decisions on These Issues Must be Given Weight

Following the issuance of a Commission decision, a party seeking to modify that decision must first request rehearing of the Commission's decision.[30] Following denial of an application for rehearing, a party to a rate proceeding must appeal the Commission's

[26] Ex. A-13 at 4.
[27] *Id.*
[28] *Id.*
[29] AAC R14-2-411.D.2; AAC R14-2-610.D.2; NARUC USOA at 56. RUCO's own engineering witness acknowledged that a change in depreciation rates or an amortization of the balance was the appropriate method to address this issue, yet RUCO's position remains unchanged. Tr. at 920-21. Not surprisingly, there was no mention of voiding of debit balances being common in the industry, and RUCO's witness was not aware that RUCO had made this recommendation. *Id.*
[30] A.R.S. § 40-253.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

decision within thirty days of the denial of the application for rehearing.[31] Once a Commission decision becomes final, it is conclusive and therefore, not subject to collateral attack.[32]

The Commission, of course, has broad authority to modify and amend its prior decisions. While broad, that power is not without constraint. The Commission cannot modify any final Commission order without following a process that allows the affected utility notice and the opportunity to be heard "as upon a complaint".[33] The Commission's statutes governing complaints invoke certain procedural requirements as set forth in sections 40-246 through 40-249 of the Arizona Revised Statutes, which provide a notified party with due process as to the Commission's intent to consider the modification of a prior decision.[34]

Case law also constrains the purpose for which the Commission may modify a final order. Arizona courts have made clear that "the exercise of the Commission's power [pursuant to Section 40-252] requires showing due cause for such action - an affirmative showing that the public interest would thereby be benefited."[35] Therefore, as with any complaint, the burden is on the party seeking to modify the Commission order to show that such a modification is in the public interest.

Not only do general statutory provisions and related case law support the finality of Commission decisions, in this case, the NARUC USOA affirmatively recognizes the finality of accounting treatment given by the Commission of accumulated depreciation from prior periods.[36] As set forth in the NARUC USOA, the only instances in which a prior period adjustment to these accounts may be considered are (1) corrections of an error in the financial statements of a prior period; or (2) certain income tax benefits relating to

---

[31] A.R.S. § 40-254.01.
[32] A.R.S. § 40-253; *Miller v. Ariz. Corp. Comm'n*, 227 Ariz. 21, 24, 251 P.3d 400, 404 (Ct. App. 2011).
[33] A.R.S. § 40-252.
[34] A.R.S. §§ 40-246 to -249.
[35] *Ariz. Corp. Comm. v. Tucson Ins. and Bonding Agency*, 3 Ariz. App. 458, 463, 415 P.2d 472, 477 (Ct. App. 1966).
[36] NARUC USOA, Accounting Instruction 8 (attached as Exhibit B).

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

preacquisition loss carry forwards of purchased subsidiaries.[37] With specific regard to accumulated depreciation balances, the NARUC USOA mandates that changes to accounting methods not be considered accounting errors and, therefore, are not subject to prior period adjustments.[38] In this case, Staff and RUCO are in effect changing the Commission's methodology regarding debit balances.[39] This cannot be considered an error, however, and therefore, this newfound approach cannot be a basis for voiding these debit balances.

In the most recent *Goodman Water Company* rate case, the Commission, at the urging of Commission Staff, recognized the limitations placed upon prior period adjustments. In that case, Goodman Water Company ("Goodman") and RUCO entered into a settlement agreement allowing Goodman to defer accumulated depreciation on certain plant until the end of the test year and to defer annual depreciation expense on certain plant until Goodman's next rate case.[40] In opposition to the Settlement Agreement, Staff, citing Accounting Instruction 8 from the NARUC USOA, argued that the treatment of depreciation in that case violated Commission-required accounting principles:

> Staff claims that there is no accepted methodology, in either NARUC's Uniform System of Accounts ("USOA") or in Generally Accepted Accounting Principles ("GAAP"), for either voiding or deferring accumulated depreciation (i.e. depreciation that has already occurred). Staff asserts that the USOA and GAAP indicate that reversal of accumulated depreciation is improper.[41]

Staff further argued that, unless an error could be shown, accumulated depreciation amounts which were properly recorded should not be "manipulated."[42] Ultimately, the Commission approved the Settlement Agreement based on the specific issues in that case

---

[37] *Id.*
[38] *Id.* ("Changes in depreciation or amortization estimates or methods are considered changes in accounting estimates rather than accounting errors; and therefore are not subject to prior period adjustments.")
[39] Their recommendations would also be contrary to NARUC USOA depreciation principles and methodology which establish proper cost recovery through the use of average service lives and resultant depreciation rates.
[40] Decision No. 72897 (Feb. 21, 2012) at 11-12.
[41] *Id.* at 14-15.
[42] *Id.* at 15.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

relating to excess capacity, but did not make any determination as to the treatment of the depreciation expense in the future rate case.[43]

Unlike the *Goodman* case, in which the Commission had not made a prior determination as to appropriate accumulated depreciation balances, in this case, the Commission has specifically approved prior balances. The same concerns raised by Commission Staff in the *Goodman* case must govern here. Unless an error can be shown, proper accounting does not allow for the Commission to undo balances previously approved and recorded by the Company.[44] RUCO and Staff, following detailed examination of balances in this case, did uncover certain inconsistencies in the current plant balances.[45] Those have been adjusted in the Company's Final Schedules and are no longer at issue.[46] Although the Company does have the burden to show changes to its plant and depreciation schedules from the last rate case, logic dictates that the Company does not have a burden to disprove general, unsubstantiated accusations that errors must exist in the Company's prior accounting, particularly, when as here, these balances have been fully litigated in prior rate cases. Such an approach would be contrary to the presumptive finality of Commission decisions, as well as requirements of the NARUC USOA, which governs utility accounting and is required by the Commission for water and wastewater utilities.[47]

3. If the Commission Determines that the Debit Balances Should be Addressed, the Balances Must be Amortized Over a Period of Years to Allow for Recovery

As explained by Mr. Guastella in his testimony, the Commission's prior decisions reflect the proper and normal accounting for retirements, as required by the NARUC USOA.[48] If it is determined in this case that these balances must now be addressed, the

[43] *Id.* at 22.
[44] NARUC USOA, Accounting Instruction 8 (attached as Exhibit B).
[45] Ex. R-33; RUCO's Schedules; Staff's Schedules.
[46] Company's Schedules.
[47] AAC R14-2-411.D.2; AAC R14-2-610.D.2; NARUC USOA at 56.
[48] Ex. A-13 at 3-5.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

Commission must allow for the recovery of the undepreciated balances through an amortization and include average unrecovered balances in rate base.[49] Under this treatment, as recognized by NARUC USOA and by the Commission, the Company would be made whole.[50]

RUCO's own expert also discussed the propriety of allowing for a recovery of debit balances through an amortization. As discussed in his testimony, Mr. Radigan explained that use of amortization in other jurisdictions to address under-collected balances is a common occurrence.[51] Interestingly, Mr. Radigan was not aware of RUCO's proposal in relation to the debit balances and provided no support for the voiding of accumulated depreciation balances as recommended by RUCO.[52]

Although the Company believes that, consistent with NARUC accounting and the group method, the most appropriate approach is to keep these accurate balances until group depreciation provides recovery of the unrecovered amounts, if the Commission determines that another approach should be utilized, it must establish a regulatory asset and amortize the unrecovered amounts to expense over a period of time with average unamortized balances included in rate base.[53] The recovery of the investment that was retired before the end of its useful life would be spread over the remaining average service life by applying the group depreciation rates authorized by the Commission for that asset group.[54]

As noted above, the majority of the debit balances coming into existence since the last rate case relate to early retirements in the Mohave Wastewater District.[55] There is no dispute that these recent retirements have occurred and have been accounted for properly.[56]

---

[49] *Id.* at 3-4; *see also* Ex. R-26 at 26-27 (Radigan); Tr. at 920-21.
[50] Ex. A-13 at 3-5.
[51] Ex. R-26 at 26-27; Tr. at 920-21
[52] Tr. at 920-21.
[53] Ex. A-9 at 9-11; Ex. A-13 at 5.
[54] Ex. A-9 at 9.
[55] Ex. A-9 at 1, Exhibit SLH-3RJ; Ex. A-55; Tr. at 132.
[56] Although RUCO questions the adequacy of the Company's insurance policies, this is not a basis for voiding this valid retirement. As Ms. Hubbard explained, this retirement resulted from a flood and there is no evidence in the record that the Company did anything wrong in relation to this casualty. Tr. at 133.

Therefore, by way of example, if the Commission desired to address these specific retirements, it would look at the Account 380100 - Treatment and Disposal Equipment, which has an average service life of 27.78 years (a depreciation rate of 3.60%).[57] The retirement amounts, $467,154 and $1,209, would be treated as an extraordinary event and reclassified to a regulatory asset account and amortized at the same rate as the depreciation rate of 3.60 percent to Depreciation and Amortization expense.[58] The impact of this reclassification would increase the revenue requirement for Mohave Wastewater by $16,861 ($468,363 x 3.6%) annually for the remaining service lives of these assets.[59]

B. Credit Balances

As with the debit balances, there is no evidence that the Company applied any incorrect depreciation rates to the accounts that currently have accumulated depreciation balances that are greater than the associated plant balances, also referred to as net book values less than $0, or credit net book values.[60] Further, there is no dispute that the customers paid the rates approved by the Commission.[61] Finally, there is no dispute that the Company did not earn its authorized return in any of the districts that are part of this rate case.[62]

Net book values less than $0 (or credit net book values) arise when certain plant remains in service beyond its estimated service life.[63] What must be noted with regard to these balances is that the amount of depreciation expense recorded on fully depreciated accounts was a credit to accumulated depreciation and, therefore, a reduction to rate base.[64] Therefore, there was no adverse impact on customers. In fact, customers received an

[57] Ex. A-9 at 10.
[58] *Id.*
[59] *Id.*
[60] *Id.* at 12; Tr. at 491, 845.
[61] Tr. at 491, 845.
[62] Company's Schedules, Schedule A-1 (for each district).
[63] Ex. A-8 at 13; A-9 at 20.
[64] Ex. A-13 at 6-7.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

additional benefit through the reduction in rate base that the additional accumulated depreciation provided.

On a prospective basis, the Company has agreed to Staff's recommendation to cease depreciating those accounts that are fully depreciated.[65] As a result, unlike the benefit received by customers in the past, on a going forward basis, customers will no longer receive the corresponding reduction to rate base that results from the continued depreciation between rate cases of these assets which remain in service longer than their average service lives.[66]

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

1. RUCO's Proposed Regulatory Liability Constitutes Retroactive Ratemaking

Although there is no dispute by the parties that the Company has charged its customers rates approved by the Commission and has utilized the Commission-approved depreciation rates, RUCO seeks to refund to customers amounts related to these credit balances by creating a regulatory liability.[67] Although the Commission may possess the power to change its accounting treatment for specific items, "to avoid running afoul of retroactive ratemaking, such changes should not affect past losses or gains."[68] The regulatory liability that RUCO seeks to create is a classic example of retroactive ratemaking as it seeks to credit back to customers amounts that the Company properly charged under prior Commission decisions. RUCO's approach also constitutes single issue ratemaking, as RUCO has not examined any other expense items to determine if the Company has under-earned on those items. For these reasons, it must be rejected.

As noted above, the Company has not earned its authorized return in any of the districts that are the subject of this rate case. Although it would clearly violate the law for

---

[65] Ex. A-9 at 19; Ex. A-14 at 4.
[66] Ex. A-9 at 20.
[67] Ex. R-14 at 32-34.
[68] Decision No. 72897 at 21 (citing Kriegar, Stephan H., *The Ghost of Regulation Past: Current Applications of the Rules Against Retroactive Ratemaking,* 1991 U. Ill L. Rev at 998).

the Commission to allow the Company to recover in future rates expense items not fully recovered in prior rates (so that the Company would be guaranteed its authorized return), this is no different than what RUCO attempts to do with this regulatory liability. For example, as described by Mr. Lenderking in his testimony, the Company has not included accurate power costs in its CAP Surcharge mechanism since 2008 when the power cost savings related to the exchange of CAP Water and well water ceased.[69] Clearly, the Commission would not authorize the Company to make up that prior loss in future rates. For the same reason that the Commission would not authorize the Company to increase future rates to make up for prior under-recoveries, the Commission must reject RUCO's proposal.

II. POST-TEST YEAR PLANT ADDITIONS

The Company and Commission Staff recommend identical amounts for post-test year plant additions.[70] As is the current policy for Commission Staff, the Company has provided support and is seeking to include in rate base revenue-neutral, post-test year plant additions net of associated retirements for the period ending one year after the test year.[71] Both Mr. Thompson and Mr. Radigan surveyed this plant and both agree that the post-test year plant additions requested by the Company are in service and used and useful for the Company's test year customers.[72] Ms. Rimback also confirmed that the Company has supported post-test year plant additions through invoices in the same manner as it does for test year plant additions.[73] RUCO, however, despite there being no dispute that this plant is in service and despite there being no argument regarding the validity of the amounts for such plant, continues to rely upon an arbitrary six-month end point for post-test year plant.

---

[69] Ex. A-21 at 16.

[70] Ex. S-1 at Exhibits MST-1 to -4; Thompson Supplemental Direct Testimony at 6; Staff's Schedules at Sch. MJR-4 (for each district).

[71] *Id.*; Ex. A-15 at 3; A-17 at 2-3.

[72] Ex. S-1 at Exhibits MST-1 to -4; Thompson Supplemental Direct Testimony at 6; Tr. at 915.

[73] Tr. at 824, 831.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

RUCO also seeks to make a distinction between the Company's post-test year investment projects and its recurring projects.[74] However, although the Company makes this distinction for planning purposes, there is no distinction as to the importance of these projects for the provision of safe and reliable drinking water and wastewater service to the Company's test year customers.[75] As Mr. Bradford explained in his testimony:

> Q. And why did EPCOR include RPs . . . as post-test year plant in this case?
>
> A. I think from the company's perspective they are absolutely vital for us to provide service to our water customers. They are certainly critical to the infrastructure. And, you know, our job number one is to provide safe and reliable water and wastewater services. And the RPs that are included . . . as part of this rate case are certainly vital for us to maintain that service.
>
> Q. Have similar RPs been included in post-test year plant in prior rate cases by EPCOR?
>
> A. Yes. Actually, in the last Chaparral City Water Company rate case, the company had requested for post-test year plant IPs, what we call the investor projects, and RPs. And actually Staff had analyzed those costs and found them to be reasonable and appropriate and were included in the rate case and actually approved by the Commission.[76]

All of the Company's post-test year projects "are critical to ensuring the delivery of safe and reliable water service to our customers, they are significant investments that were completed within 12 months of the test year in this proceeding and they are in use and providing benefit to [the Company's] customers."[77]

Although RUCO claims that the inclusion of all of the Company's post-test year projects violates Commission policy, RUCO ignores recent Commission decisions on post-test year plant. As noted above, in the Chaparral City Water Company decision, Decision No. 74568 (June 20, 2014), this Commission agreed with Commission Staff's recommendation to include all post-test year projects completed within 12 months of the

---

[74] Ex. R-26 at 9.
[75] Ex. A-17 at 2-3; Tr. at 1061, 1070.
[76] Tr. at 1061-62.
[77] Ex. A-17 at 2.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

end of the test year.[78] Consistent with Commission requirements that pro forma adjustments be known and measurable, all of these projects were completed and providing service to test year customers prior to the end of the 12 month period following the test year.[79] The same is the case here.[80]

III. COST OF CAPITAL

RUCO and Commission Staff recommend rates of return on the Company's equity that are below what is reasonable and appropriate. In its *Bluefield* decision in 1923, the United States Supreme Court set forth the criteria for determining whether a rate of return is reasonable:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments on other business undertakings which are attended by corresponding risks and uncertainties . . . . The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market, and business conditions generally.[81]

The Supreme Court further held that "[r]ates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment."[82]

In its later *Hope* decision, the Court gave further definition to the standard:

> [T]he return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return,

[78] Decision No. 74568 at 5-6.
[79] *Id.* at 6.
[80] Ex. A-16 at 5.
[81] *Bluefield Water Works & Improvement Co. v. Pub. Ser. Comm'n of West Virginia*, 262 U.S. 679, 692-93 (1923).
[82] *Id.* at 690.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

> moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[83]

Consistent with these decisions, under *Hope* and *Bluefield*, the following must be used as guidance:

> (1) The return should be similar to the return in businesses with comparable risks;
>
> (2) The return should be sufficient to ensure confidence in the financial integrity of the utility; and
>
> (3) The return should be sufficient to maintain and support the utility's credit.

A. The Commission Should Adopt a Cost of Equity of 10.55 Percent.

As is often the case, the dispute over cost of equity arises around the models used and the expert analysis given to those models to determine an appropriately comparable return for adoption by the Commission. In her testimony, Ms. Ahern, an expert with vast experience and superb credentials, provided ample and credible support for her cost of equity recommendation.[84]

Because EWAZ's common stock is not publicly traded, a market-based common equity cost rate cannot be determined directly for EWAZ.[85] As a result, Ms. Ahern, as did Commission Staff and RUCO, arrived at her recommendation through the use of a proxy group of companies with relatively similar, although not identical, risks.[86] Because no proxy group can be selected that is identical to the Company, using her informed expert judgment, Ms. Ahern appropriately adjusted the results of the proxy groups to reflect the unique financial and business risks of the Company.[87] Therefore, in accordance with proper cost of capital analysis, after determining an appropriate cost of capital for the

---

[83] *Fed'l Power Comm'n v. Hope National Gas Co.*, 320 U.S. 591, 603 (1942).
[84] Ex. A-32, Ex. A-33, Ex. A-34.
[85] Ex. A-32 at 3.
[86] *Id.*
[87] Ex. A-32 at 4, 42-45; Ex. A-33 at 59-60.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

proxy group, Ms. Ahern made well-supported business risk, credit risk and economic risk adjustments to reach her cost of capital recommendation of 10.55%.[88]

Unlike Commission Staff, which relied solely on one model, Ms. Ahern relied upon the application of market-based cost of common equity models, including the Discounted Cash Flow ("DCF") model, the Risk Premium Model ("RPM") and the Capital Asset Pricing Model ("CAPM"), to the market data of the proxy group of nine water companies.[89] Ms. Ahern adjusted her results during the pendency of this proceeding by incorporating more recent data when available.[90] After reviewing the cost rates based upon each of the models, Ms. Ahern conservatively concluded that these models produced a common equity cost rate of 9.72% before her recommended adjustments for financial/credit risk and business risk as a result of EWAZ's greater credit and business risks relative to the proxy group of nine water companies.[91] Ms. Ahern also adjusted her results through the use of a portion of Commission Staff's economic risk adjustment.[92] Based on her analysis, Ms. Ahern found that the common equity cost rate based upon the proxy group must be adjusted upward by 24 basis points to reflect the Company's credit risk and upward by an additional 30 basis points to reflect EWAZ's greater business risk.[93] Adding Mr. Cassidy's 60 basis points upward economic assessment adjustment "[i]n consideration of the relatively uncertain status of the economy and the market that currently exists"[94] to the updated common equity cost rate of 10.25% results in a 10.85% common equity cost rate. Ms. Ahern determined that the midpoint of 10.55% (*i.e.* using one half of Staff's total economic adjustment) was the appropriate cost rate for EWAZ in the current economic and capital market environment.[95]

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

---

[88] *Id.*
[89] Ex. A-32 at 19-41.
[90] Ex. A-33 at 59-60.
[91] *Id.* at Ex. PMT RT-1, Sch. 9.
[92] Ex. A-33 at 59-60.
[93] *Id.* at 60.
[94] *Id.*; Ex. S-8 at 39.
[95] Ex. A-33 at 59-60.

Ms. Ahern's recommendations based on this analysis are summarized below:

	Proxy Group
Discounted Cash Flow Model	8.52%
Risk Premium Model	10.97%
Capital Asset Pricing Model	9.72%
Indicated Common Equity Cost Rate (before Adjustments)	9.72%
Credit Risk Adjustment	0.24%
Business Risk Adjustment	0.30%
Indicated Common Equity Cost Rate	10.26%
Recommended Common Equity Cost Rate (rounded)	10.25%
Adjusted to include one-half of Staff's 60 basis point economic risk adjustment	10.55%

B. The Commission Should Use Multiple Models in Determining an Appropriate ROE.

Commission Staff used only one model, the DCF model, in its analysis.[96] This approach, which lacks diversity and is contrary to the Efficient Market Hypothesis, results in under-earning when applied to the original cost less depreciation rate base (*i.e.*, book value).[97] The use of additional models, including the Company's CAPM and risk premium models, provides the analysis of cost of capital with diversity and appropriate perspective. As displayed above, when all models are used, which is appropriate for a cost of capital analysis, a conservative analysis leads to a conservative recommendation of 9.72% before adjustments are made.

Ms. Ahern's CAPM analysis is bolstered by the examination of Empirical CAPM (ECAPM) in conjunction with standard CAPM.[98] ECAPM addresses the tendency for

[96] Ex. S-8.
[97] Ex. A-33 at 11-16.
[98] Ex. A-32 at 36; Ex. A-33 at 40.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

standard CAPM to be skewed in the water industry where betas vary significantly from 1.0.[99] As testified by Ms. Ahern, the average ECAPM cost rate is 10.14%, while the median is 10.21%, which provides broader support for her recommendation.[100]

Ms. Ahern's risk premium analysis also includes multiple models, which bolsters support for her recommendation.[101] Ms. Ahern incorporates the Predictive Risk Premium Model (PRPM™) which utilizes the actual results of investor behavior rather than subjective judgments.[102] As discussed by Ms. Ahern in her direct testimony, the average PRPM™ for the proxy group is 13.67% and the median is 11.68% for the nine water companies.[103] Ms. Ahern's Risk Premium analysis uses the adjusted total market approach which uses five different sub-models.[104]

When viewed in total, there should be no dispute that Ms. Ahern's broad-based analysis provides ample support for her recommendation of a cost of equity of 10.55%.

C. Forward-Looking Data Should Be Used in Determining an Appropriate CAPM

Investors, who make decisions based on expected benefits, are forward looking. In addition, historical data is already considered as part of the forward looking estimates.[105] The forward-looking approach used by Ms. Ahern in her analysis is a primary reason that the Company's CAPM analysis (9.72%), rather than RUCO's historical looking CAPM analysis (7.48%), should be used.[106] As discussed in detail by Ms. Ahern, Mr. Mease's CAPM analysis is flawed for multiple reasons. First, Mr. Mease incorrectly relies upon a recent three-month average of 20-year Treasury bonds despite the fact that both

---

[99] Ex. A-33 at 40-41.
[100] Ex. A-32 at 40.
[101] Ex. A-32 at 26-35.
[102] *Id.* at 32-35.
[103] *Id.* at 28.
[104] *Id.* at 26-35.
[105] Ex. A-34 at 19.
[106] Ex. A-33 at 33-38.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

ratemaking and the cost of capital are prospective.[107] Although Mr. Mease recognizes the strength of the CAPM as a "forward looking model," he fails to utilize appropriate forward looking data in calculating his CAPM. Second, Mr. Mease incorrectly calculates his market equity risk premium by relying upon the historical mean total return on U.S. Treasury securities and by not employing a prospective or forward-looking equity risk premium.[108] As Ms. Ahern notes, with regard to the equity risk premium, the income return should be used rather than the total return on U.S. Treasury securities.[109]

When corrected as noted above, Mr. Mease's three analyses produce the following results:[110]

Water Group	
DCF	8.74%
CAPM	9.73%
CE	10.9%

An average of these cost of capital results (consistent with Mr. Mease's own method),[111] produces a common equity cost rate of 9.79%.[112] However, this 9.79% still understates the Company's cost of capital, as it does not reflect any adjustment for credit risk, economic risk, or the Company's greater business risk due to its smaller size relative to the proxy group. Properly including these adjustments, coupled with a properly applied CAPM analysis, as well as Mr. Mease's DCF and Comparable Earnings ("CE") analyses, results in a 10.33% common equity cost rate.[113]

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

[107] *Id.* at 33-35.
[108] *Id.* at 35-37.
[109] *Id.*
[110] *Id.* at 42.
[111] *See* Ex. R-21 at 3 and Sch RBM-2.
[112] Ex. A-33 at 42-43.
[113] *Id.* at 45.

D. Adjustments Must be Made to Address the Differences Between the Company and the Proxy Group.

Commission Staff and RUCO ignore the differences between the proxy groups and the Company. Based on an analysis of these differences, a credit risk adjustment of 24 basis points is warranted based on the Company's likely bond rating compared to the proxy group.[114] With respect to the credit risk adjustment, Commission Staff and RUCO challenge the use of bond ratings on a theoretical basis but offer no quantifiable evidence to rebut Ms. Ahern. Quite to the contrary, Mr. Mease concedes that the Company's surrogate bond rating is more risky than the bond rating of the proxy group, and during cross examination, the logic for Ms. Ahern's adjustment becomes clear:

> Q. Would you agree, Mr. Mease, that an A plus bond rating is a stronger or higher rating than an A minus bond rating?
>
> A. Yes, I would.
>
> Q. And that a company with an A [plus] bond rating is perceived as less risky than a company with an A minus bond rating, would that be fair?
>
> A. That's a fair statement, yes.
>
> Q. And you understand that EPCOR Utilities, the ultimate parent company of EPCOR Arizona, has a bond rating of A minus?
>
> A. I am aware of that.
>
> Q. Okay. And would it be a fair surrogate to use that A minus rating for EPCOR Arizona in these proceedings?
>
> A. Yes.
>
> . . . .
>
> Q. And do you see that on those two pages – on page 6, [Ms. Ahern] has indicated the bond ratings of the proxy group. And on page 7, she has explained the weighting of those various companies for purposes of her average. Do you see that?
>
> A. I do.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

---

[114] *Id.* at 31.

Q. Okay. And do you see that the average that she has calculated for the proxy group is A plus bond rating?

.... Do you see that?

A. I do.

Q. Okay. And do you understand that what Ms. Ahern is proposing in her 24 point credit risk adjustment is to make an adjustment so that, to account for the fact that EPCOR Water USA has an A minus rating and the proxy group has an A plus rating? Do you understand that's her point?

A. I see that, yes.[115]

In addition to the credit risk adjustment, a business risk adjustment of 30 basis points is warranted based on the Company's small size compared to the proxy group.[116] Neither RUCO nor Staff offers any empirical evidence to rebut the business risk adjustment other than general allegations that the Company does not face a greater business risk than the proxy companies and claims relating to the Company's payment of dividends.[117] Although Mr. Mease relies on Ibbotson in his risk premium analysis, he fails to counter the support from Ibbotson relied upon by Ms. Ahern for her business risk adjustment.[118] As set forth by Ms. Ahern in her testimony, using her proxy group and the proxy group utilized by Staff, as well as Ibbotson data relating to the size premia of these proxy groups, Ms. Ahern calculates the business risk faced by the Company due to its smaller size.[119]

As such, the two adjustments made by Ms. Ahern bring the Company in line with the proxy group for purposes of determining the Company's cost of equity.

E. Staff's Economic Risk Adjustment Should Be Used

The Company also supports Staff's additional economic risk adjustment of 60 basis points.[120] Unlike the two prior adjustments, which account for the differences between the

---

[115] Tr. at 672-74.
[116] Ex. A-33 at 31.
[117] Ex. R-21 at 24-25; Ex. S-8 at 82-83.
[118] Tr. at 674-75.
[119] *Id.*; Ex. A-33 at 30-31.
[120] Ex. A-33 at 60.

Company and the proxy group, this adjustment addresses the risks faced by the water industry in totality.[121] This adjustment is particularly needed in light of the growing risks to the water industry in the West due to water supply, drought and shortage issues. Although Staff utilized a 60 basis point adjustment to its cost of capital recommendation, Ms. Ahern applied one-half of this adjustment to her updated common equity cost rate of 10.25%, which resulted in a 10.55% common equity cost rate as the appropriate rate for EWAZ in the current economic and capital market environment.[122]

IV. 24-MONTH DEFERRAL OF AFUDC AND DEPRECIATION

Depreciation, unless recovered in rates, immediately begins to drain a utility's earnings, resulting in reduced returns on equity.[123] A utility's inability to recover the return and the associated depreciation when new plant is put into service until a new rate decision is issued has long been referred to as "regulatory lag".[124] The impact of this regulatory lag can be demonstrated by looking at the cost of $1 million dollars of investment placed in service when a rate decision is issued 24 months after the first day of the test year. For every $1 million of investment at a 6.81% cost of capital (debt and equity as requested by the Company), and a composite depreciation rate of approximately 3%, the annual lost revenue to the Company is approximately $157,000 of revenue, or $13,080 per month.[125]

In recognition of the impact of regulatory lag, Commission Staff recommended in a 2012 Staff Report that the Commission consider a 24-month deferral approach in the same manner as requested by EWAZ in this matter.[126] Commission Staff's Report explained its recommendation in detail and its Report provides further support for the Company's request:

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

---

[121] Ex. S-8 at 39; Tr. at 693, 696, 705.
[122] Ex. A-33 at 60.
[123] Ex. A-8 at 15.
[124] *Id.* at 16.
[125] *Id.* at 15.
[126] Ex. A-38.

Under present treatment, utilities record projects in the CWIP accounts and are allowed to record AFUDC on those balances using a rate that equals the utility's cost of capital. Upon transferring the cost of the completed project from CWIP to UPIS, the recording of AFUDC ceases and the utility begins depreciating the asset. During the interim period between the transfer from CWIP to UPIS and the date when the asset may be recognized in rate base, the utility bears the carrying costs of the asset which are unavoidable and unrecoverable under the present regulatory process. Once a project is completed, it is transferred to UPIS.

Staff recommends that some consideration be given to mitigating the effects of carrying costs of net plant additions between rate proceedings. Under optimal conditions, a utility would transfer plant to UPIS concurrently with filing a rate case which would require up to 12 months to process. In addition, Staff prefers 12 months of data after a Company has received new rates before it can file another rate case. Realistically, the utility will bear the carrying costs of the incremental net plant additions during the interim period which is at least 24 months. While the utility is technically not entitled to earn on that incremental plant absent a fair value determination, Staff recommends that some consideration be given to mitigate effects of associated carrying costs which could be significant. **Staff recommends the deferral of post-in-service AFUDC for a period of up to 24 months to mitigate the effect of regulatory lag.**

Staff also recognizes that a utility records depreciation expense from the date that the asset is placed into service. If this occurs during or prior to the end of the test year in a rate proceeding, the utility incurs depreciation expense but has no opportunity to recover it. Similar to the reason associated with regulatory lag discussed more fully above regarding post-in-service AFUDC, **Staff further recommends that depreciation expense be deferred for a period of up to 24 months to mitigate the effects of regulatory lag.**[127]

Approval of the Company's 24-month deferral request in rates would allow for the recovery of the deferred carrying costs (AFUDC) and depreciation throughout the test year beginning on the first day of the test year, which in this case is July 1, 2012.[128] As requested by EWAZ, the deferred amount would include AFUDC and depreciation on plant placed in service throughout the test year and for the following 12 months *(i.e.* the 24-month period requested here).[129]

Although both Commission Staff and RUCO have recommended a rejection of EWAZ's request for this deferral mechanism, they do so, at least in part, based upon a faulty premise that this request is duplicative of the Company's request for a SIB

[127] Ex. A-38 at 2-3 (emphasis added).
[128] Ex. A-8 at 7, 18.
[129] *Id.* at 16.

mechanism, which is not the case. It is important to note that EWAZ first made this request following Commission Staff's issuance of its Staff Report as part of a stand-alone filing.[130] In that proceeding, both RUCO and Staff indicated that this type of request should be made in a rate case.[131] Following that advice, EWAZ made the request here.

As explained by Ms. Hubbard, the deferral would be unnecessary if rates could be adjusted to provide a return on investment in a shorter period of time than is now the case.[132] Given the time necessary to process a rate case, however, EWAZ strongly agrees with Commission Staff's prior recommendation that this 24-month deferral mechanism is an appropriate means to address regulatory lag.

This request in no way seeks to recover amounts that would be recovered by EWAZ under the SIB mechanism.[133] As noted by Ms. Hubbard, this 24-month deferral mechanism is intended to recover a return on and of assets placed in service on the first day of the test year through the 24-month period that ends with the issuance of the Decision.[134] In this case, there is no potential overlap as the Company's calculation does not include the time period in which the SIB mechanism would be in place.[135]

As set forth in the Company's Final Schedules, EWAZ's deferral request is in the amount of $1,666,289, with a requested amortization of $49,659.[136] These amounts reflect actual additions to plant during the 24-month deferral period.

V. OTHER RATE BASE ITEMS

A. CIAC in CWIP

For each district, the Company made an appropriate adjustment to properly match the CIAC amortization to the depreciation deduction associated with developer-funded

---

[130] *See* Docket Nos. SW-01303A-12-0427 *et al.*
[131] *See* Procedural Order dated July 2, 2013, Docket Nos. SW-01303A-12-0427 *et al.*
[132] Ex. A-8 at 17.
[133] *Id.* at 17-18.
[134] *Id.*
[135] *Id.*
[136] Company's Schedules. These amounts are adjusted from the amounts shown in the Company's rebuttal testimony given changes made during the rejoinder phase of the case.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

projects.[137] CIAC attributable to developer-funded projects remaining in construction work in progress (CWIP) at the end of the test year must be removed from the calculation of rate base.[138] When plant funded by developer contributions is in CWIP at the end of the test year, there will not be any depreciation expense on that plant reflected in the income statement.[139] If the associated CIAC is included as a reduction to rate base (as proposed by RUCO), the associated amortization reduces depreciation expense in the determination of the cost of service creating a mismatch between depreciation on developer-funded plant and the related amortization of the CIAC.[140]

The adjustment made by the Company, and accepted by Commission Staff, preserves the matching principle by removing the CIAC and its associated amortization until such time as the depreciation on the related plant is included in rate base.[141] Developer-funded CWIP does not accumulate any allowance for funds used during construction (AFUDC) and the Company does not earn anything on the developer-funded projects either while they are in CWIP or when they are completed and transferred into plant in service.[142]

The position taken by RUCO, which RUCO admits is contrary to current Commission policy, must be rejected in order to preserve a matching of the depreciation expense and the related amortization of the CIAC on developer-funded plant.[143] Absent the adjustment proposed by the Company to exclude the developer-funded CIAC associated with plant that remains under construction and part of CWIP at the end of the test year, depreciation expense included in customers' rates will be understated. To make one adjustment to reduce depreciation expense without providing the Company the

---

[137] Ex. A-8 at 20.
[138] *Id.*
[139] *Id.*
[140] *Id.* at 20-21.
[141] *Id.* at 20.
[142] *Id.* at 21.
[143] *Id.*; Ex. R-15 at 19-20.

opportunity to make an off-setting adjustment for the amortization is inappropriate and contrary to current Commission policy.[144]

B. Cash Working Capital

Contrary to the position of Commission Staff, rate case expense should not be excluded from the calculation of cash working capital. Commission Staff recommends exclusion of rate case expense from the calculation of cash working capital stating the amount included in the income statement is a non-cash amortization expense in future operating years and therefore, should be excluded.[145] Rate case expense is a normal operating expense of the Company and requires the provision of investor capital to pay for that expense.[146] Cash is expended for the incurred expenses and there is an associated lag in the recovery of that expense from customers, which is the premise of providing an allowance for cash working capital.[147]

The Company has historically used the annual amortization amount of rate case expense as the basis for this expense because this is the manner in which the Commission historically authorizes recovery of this expense item.[148] For Commission Staff to exclude this expense from the calculation of cash working capital without any consideration of the long period of time between when the Company incurs the expense and when it is recovered in rates is simply unreasonable.

The Commission should also reject RUCO's adjustment to cash working capital relating to bad debt expense. RUCO proposed to exclude bad debt expense from the working capital calculation even though the Company's bad debt expense is based on actual debts written off and on uncollectible accounts which represent a loss of revenue to the Company and should be included in the calculation of the cash working capital.[149]

---

[144] *See, e.g.*, Decision No. 72251 at 46-47.
[145] Ex. S-14 at 27.
[146] Ex. A-9 at 13; Ex. A-8 at 19.
[147] *Id.*
[148] Ex. A-8 at 19.
[149] Ex. A-8 at 20.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

RUCO has revised the calculation of the interest expense lag based upon a hypothetical payment process, while EWAZ's lag is based on actual payment history.[150]

C. Tubac Rate Base

The Company disagrees with Staff's recommendation to remove from rate base the entire net amount of $178,533 ($249,315-$70,762) currently included in Account 320200 Water Treatment Equipment-Media.[151] Although this account includes arsenic media, it also includes an allocation of treatment plant engineering costs and overhead incurred during the construction of the arsenic treatment plant, and, therefore, it is not appropriate to remove the entire amount.[152] As set forth in the Company's Schedules, once all proper adjustments are made, the amount of $172,839 ($249,315-$76,476) should remain in rate base as part of Account 320100 Water Treatment Equipment-Non Media.[153]

The Company has proposed, and RUCO has agreed, that arsenic media replacement costs of $101,712 should be recovered through a surcharge mechanism over a three-year period.[154] These arsenic media replacement costs were deferred pursuant to the Company's Tubac Arsenic Cost Recovery Mechanism ("ACRM") and reflected in the Company's initial application as deferred debits in the rate base Schedule B-1 and should not be confused with the amounts in Account 320200 discussed above.

VI. OPERATING INCOME ISSUES

A. Incentive Compensation

Both Commission Staff and RUCO propose a decrease to expenses (both labor expense and corporate allocation expense) relating to incentive compensation. Incentive compensation is a key component of the Company's calculation of salary and wages, and much like salary and wages, is intended to provide incentive for employees to work safely,

---

[150] *Id.*
[151] Ex. A-9 at 16; Ex. S-15 at 15; Tr. at 47.
[152] Ex. A-9 at 16.
[153] *Id.*; Ex. A-2.
[154] Ex. A-6 at 2.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

efficiently, and effectively. Historically, the Commission has authorized the Company to recover all incentive compensation not tied to financial performance.[155] In prior plans utilized by American Water, the financial performance component of incentive compensation accounted for 30% of the total amount.[156] In Decision 72047 (Jan. 6, 2011), the Commission continued this established practice in relation to the Company's predecessor:

> The evidence presented does not support a deviation from past practice to disallow 30 percent of all Arizona-American's [Annual Incentive Plan] compensation expenses, including the Service Company employee-related AIP costs. In past cases, we have adopted a 30 percent disallowance of AIP costs in order to account for the portion of AIP based on the Company's financial performance. We declined to disallow any of the remaining AIP expenses because they are closely tied to salary expense. We find that the 30 percent disallowance of all AIP costs continues to provide an appropriate balance between ratepayers and shareholders, and it will again be adopted in this case.[157]

Here, only 10% of the incentive compensation is based on financial performance, and the Company has removed that component from its requested recovery.[158]

The remaining 90% of the incentive compensation is based on specific activities of the individual business units (i.e., department). There are three broad categories of activities in the areas of Health and Safety, Operational Efficiency and Customer Service. Each category is weighted equally at 30%.[159] These measures drive performance to engage and focus all employees on improving performance as a utility service provider.

Because incentive compensation is an integral part of the employees' salary structure, EWAZ remains opposed to the adjustments proposed by Commission Staff and RUCO. Incentive compensation is part of an employees' compensation package and should be treated no differently than labor expense which is a cost of service. By

---

[155] Decision No. 72047 at 50-51.
[156] *Id.*
[157] *Id.*
[158] Ex. A-8 at 24; Ex. R-24 at 22-23; Ex. RCS-5 (Public).
[159] Ex. A-8 at 24; Ex. R-24 at 22-23; Ex. RCS-5(Public).

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

providing an incentive compensation package as part of the compensation package for employees, well operated companies, such as EPCOR, are able to motivate employees to deliver results in line with the Company's culture.

EPCOR's corporate culture stresses the importance of working safely and responsibly.[160] EPCOR also stresses the importance of delivering quality customer service whether it is communicating with the customers face-to-face or through accurate billing.[161] Another operational metric monitors capital and operational expenditures to motivate employees to complete projects on time and under budget.[162] EPCOR has been able to work proactively to limit operational expenses, and because of that, many of the costs included in this rate application have increased at a pace that is at or below the rate of inflation. All of these metrics work together to provide benefits to customers. Ultimately, these amounts are no different than a labor expense and should be treated in the same manner.

B. Tank Maintenance (Paradise Valley Water District)

EWAZ has very conservatively proposed a tank maintenance plan of 14 years to ensure that maintenance occurs at a frequency that effectively extends the life of these assets while at the same time is not overly burdensome to customers.[163] This request is based on the number of tanks, the size of the tanks, the age of the tanks and the materials from which the tanks are constructed.[164] Although it would be reasonable to conduct maintenance at a more rapid pace, which would increase the cost, the Company, as explained by Mr. Stuck, believes that this approach strikes the right balance of timing and cost.[165]

---

[160] Ex. A-7 at 4-7.
[161] *Id.*
[162] Ex. R-24 at 23; Ex. RCS-5 (Public).
[163] Ex. A-18 at 5; Ex. A-19 at 2-3.
[164] Ex. A-18 at 5.
[165] *Id.*

Commission Staff, based on a thorough examination of the tanks by Mr. Thompson, and consistent with the approach approved by the Commission in prior cases, recommends the approval of this plan and the inclusion of the requested amounts as an expense item.[166] Based on its extensive analysis, Commission Staff has proposed to include this amount as an expense item, and the Company has agreed with the amount proposed by Staff.[167]

RUCO, as it has done in all recent cases, argues against this tank maintenance expense.[168] As noted by Mr. Stuck in his testimony, the Commission has approved similar tank maintenance plans (and its inclusion as an expense) for EWAZ in Decision No. 71410 (for multiple water districts) and for the Sun City Water District as part of Decision No. 72047.[169] Recently, the Commission adopted a nearly identical plan for the Company's affiliate, Chaparral City Water Company, in Decision No. 74568.[170]

As explained by Mr. Stuck, this approach to tank maintenance has been an effective means to address the tank maintenance issues in those districts.[171] These approvals have provided the Company with a specific source of revenue to perform necessary maintenance of these very critical pieces of infrastructure in a timely and systematic fashion.[172] If this maintenance is not performed regularly, it will ultimately lead to a deterioration in the tanks, which results in system disruption, loss of water to customers, and increased cost of repairs or replacement.[173]

Although the Company continues to dispute the claims made by RUCO as to the benefits of this tank maintenance approach, the Company has no objection to tracking and filing the amounts expended on tank maintenance at the end of the program period for the

---

[166] Ex. S-1, PV District Engineering Report at 17-18; Ex. S-3 at 1-2.
[167] *Id.*
[168] Ex. R-9 at 40-42.
[169] Decision No. 71410 at 36-37; Decision No. 72047 at 57-58.
[170] Decision No. 74568 at 27-28.
[171] Ex. A-19 at 2-3.
[172] *Id.* at 3.
[173] *Id.*

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

Paradise Valley Water District as RUCO recommends.[174] The Company also does not object to refunding any difference at the end of the 14-year program period if there is an over collection but believes that this true up should also include a mechanism to address any under collection that may have occurred as reflected in that future filing.

C. Accumulated Deferred Income Tax ("ADIT") and Bonus Depreciation

Accumulated deferred income taxes ("ADIT") reflect the timing difference between when income taxes are calculated for ratemaking purposes and the actual federal and state income taxes that are paid by the Company. The timing difference is primarily due to the fact that straight line depreciation is used for ratemaking purposes, whereas the Company utilizes accelerated depreciation for income tax reporting purposes.

As it has always done, the Company included all recorded ADIT as of the end of the test year in this case in the calculation of rate base.[175] This calculation is based on the amounts in the Company's corporate income tax return and is allocated to the districts by use of a 4-factor allocator based on net plant, general metered customers, labor and O&M (excluding labor).[176] ADIT related to bonus depreciation for all of EWAZ's assets placed in service during 2013 and eligible for bonus depreciation was appropriately recorded when the election to take bonus depreciation on the Company's 2013 tax return occurred in September of 2014.[177] Although Mr. Smith argues that bonus depreciation must be included to properly account for the matching principle, he failed to properly complete his matching analysis by taking into account the actual impact of the 2013 bonus depreciation deduction.[178] As explained by Ms. Hubbard, the 2013 bonus tax depreciation caused the Company's consolidated income tax return to show a taxable loss which contributed to the creation of a net operating loss ("NOL") deferred tax asset.[179] Accordingly, the actual

---

[174] Ex. A-20 at 2-3
[175] Ex. A-9 at 17.
[176] *Id.*
[177] *Id.*
[178] *Id.*
[179] *Id.*

impact of the bonus depreciation for the Company is nullified by the deferred tax asset generated by the NOL and therefore should not be used an adjustment to rate base.[180]

Additionally, accelerated depreciation, including the election to take bonus depreciation when appropriate, is always used by the Company in computing its tax liability for tax purposes. In the past, the Commission has not reached forward in time to quantify the impact of the accelerated depreciation on ADIT associated with the Company's post-test year plant additions. The impact of the accelerated depreciation on ADIT has typically been limited to the ADIT recorded on the Company's books as of the end of the test year, which is the basis of the ADIT included by the Company in this case.

D. Rate Case Expense

The Company is not seeking to recover any more than the amount of expenses actually incurred for rate case expense.[181] In addition to legal expenses and expert witness expenses, the Company contracted with outside agencies to supplement its abbreviated workforce on an hourly basis.[182] Contrary to the contentions of Commission Staff, the fact that the Company originally contracted some of its consultants for a nine district case is irrelevant, as the Company has contracted on an hourly basis for the bulk of these expenses.[183] As noted by Ms. Murrey in her testimony, as of the filing of rebuttal testimony, the Company had expended more than $540,000 on rate case expense.[184] Given the hearing and other requirements to bring this case to conclusion, regulatory expense related to this rate case will exceed the $650,000 requested by the Company for regulatory expense.

[180] *Id.*
[181] Ex. A-11 at 8.
[182] *Id.*
[183] *Id.*
[184] *Id.*

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

VII. OTHER ISSUES IN DISPUTE

a. CAP and GSF Surcharge

The CAP Surcharge and GSF Surcharge mechanisms are both efficient mechanisms that allow for the timely recovery of CAP-related expenses that are not within the Company's control. These surcharges also provide customers with important pricing signals associated with this source of water.[185] In addition, as described by Mr. Lenderking in detail in his testimony, there are several uncertainties that exist today that were not contingencies at the time of the Commission's issuance of Decision Nos. 72046 and 71481.[186] It is well known that these uncertainties include the future of the Navajo Generating Station, as well as the potential for shortages of CAP water. No party to this proceeding believes that CAP costs will not continue to increase over time.[187]

The Company has been very forthcoming about its prior failures to file annual adjustments prior to 2010 for its CAP Surcharge (Paradise Valley Water District) and its GSF Surcharge (Sun City Water District).[188] Following the recognition of those failures in 2010, the Company refunded amounts to customers and since that time has improved its internal process for calculating and filing the annual adjustment to the surcharges each year.[189]

RUCO continues to recommend against these surcharges based on the Company's continued support of these surcharges, which RUCO believes violates the prior Commission orders. The Company does not dispute that the Commission ordered the Company to include a proposal to include these costs in base rates.[190] The Company has provided that information as part of this proceeding, which the Commission may include in

---

[185] Ex. A-21 at 13.
[186] *Id.* at 10-11
[187] *See, e.g.*, Ex. R-9 at 33.
[188] Ex. A-21 at 5, 14; Ex. A-22 at 6.
[189] Ex. A-22 at 6; Ex. A-23 at 3.
[190] Ex. A-22 at 6.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

base rates if the Commission determines that these surcharges should not continue.[191] Commission Staff has testified that the Company is in compliance with the provisions of these prior orders and supports the continued use of these surcharges in recognition of the strong policy reasons favoring these surcharges for the continued purchase of this critical resource.[192]

The current CAP Surcharge calculation includes an adjustment that reduces purchased water charges by $179,225, which has been referred to as Power Cost Savings. Power Cost Savings were occurring through 2008 due to an exchange of CAP water with well water from Salt River Project.[193] Since that time, the exchange and the associated cost saving have not occurred. Instead, EWAZ is storing and recovering its CAP water.[194] As a result, the Power Cost Savings should be removed from the Paradise Valley CAP Surcharge calculation as proposed by the Company.

b. SIB Mechanism

In this case, EWAZ is seeking to implement a SIB Mechanism in its Mohave, Sun City, and Paradise Valley Water Districts.[195] In compliance with prior Commission decisions, EWAZ has provided extensive information in relation to SIB Table I, setting forth in detail all SIB projects that the Company intends to complete.[196] EWAZ prepared and submitted an extensive SIB Eligibility Report supporting in detail the need for the SIB mechanism in each of the districts.[197] Based on its review and analysis of all of the information submitted, Staff has concluded that EWAZ has met the criteria first set forth in the settlement agreement in the Arizona Water Company Eastern District matter and applied in multiple cases since that time.[198]

---

[191] *Id.*
[192] Ex. S-16 at 14-15; Tr. at 880.
[193] Ex. A-21 at 16-17
[194] *Id.*
[195] Ex. A-24.
[196] *Id.*
[197] Ex. A-25.
[198] Ex. S-1.

EWAZ's testimony makes clear that EWAZ is willing to abide by the Commission's requirements for the SIB mechanism and that it has the technical expertise and commitment to submit the required information as part of its future SIB filings.[199] As recommended by Commission Staff, EWAZ is also willing to abide by the Plan of Administration as approved by the Commission.

Despite the overwhelming evidence in support of the SIB mechanism in this case, RUCO has continued to proffer its rejected legal arguments in opposition to the SIB. The Commission has rejected these arguments in multiple proceedings.[200] Without repeating all of those legal arguments here, EWAZ notes that it supports and incorporates the legal conclusions in those decisions and continues to believe that the SIB mechanism will withstand any legal challenge if RUCO continues to challenge the SIB mechanism in the appellate courts.

In addition to its legal arguments, RUCO also continues to make policy arguments against the use of the SIB generally and in this case. In her rebuttal testimony, Ms. Coleman addressed each of the arguments made by RUCO, most of which have been rejected by the Commission in prior proceedings.[201] Perhaps most telling is the testimony of those who represent customers in the districts in which the Company seeks to implement a SIB. During his testimony, Mr. Eisert acknowledged the issues associated with aging infrastructure and the need to address these issues proactively, which is what the SIB would foster:

> [W]e are of the opinion that we do need, the company needs a proactive plan, you know, to move forward. And that may be part of what the SIB is all about. There are different, there are different areas I believe that we could work out given the Commission would be amenable to those types of things. So rather than wait until things are broken, we may want to be able to somehow come up with a plan that is proactive in getting these things done ahead of time.[202]

[199] Ex. A-24; Ex. A-26.
[200] *See, e.g.*, Decision Nos. 74568, 73938, 74081, 74364.
[201] Ex. A-26 at 2-8.
[202] Tr. at 576.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

During cross examination by Commission Staff, Mr. Eisert also recognized the benefits of rate gradualism that the SIB mechanism provides:

> Q. You just had briefly mentioned the SIB and the aging infrastructure in Sun City, is that correct?
>
> A. I did.
>
> Q. And would you rather, I guess, or the constituents you represent, would you rather pay small increases over time as that infrastructure was replaced or all at once?
>
> A. Well, obviously we would rather do small increases over time.
>
> Q. And you understand that the SIB, part of the purpose of that is to spread those infrastructure costs over a period of time instead of all at once?
>
> A. To the best of my knowledge, yes, I believe that that's true.[203]

For all of these reasons, the Commission should adopt the SIB mechanism in these districts, as proposed by the Company and supported by Commission Staff.

c. Power Cost Adjustor Mechanism (PCAM)

The best means to send appropriate price signals to customers is to enable companies to pass through cost increases and decreases in a more timely fashion.[204] With the proper determination of the base cost of power and a mechanism that includes actual sales volume true ups, an adjustor mechanism can accomplish that goal without harm to customers.[205]

In recent decisions, the Commission has continued to recognize the benefits of these types of mechanisms.[206] The Commission has also placed requirements on these mechanisms, and the Company accepts those requirements in this case.[207] The Company agrees that its PCAM should be based on gallons pumped, rather than gallons sold, and also accepts the following requirements from the recent *Litchfield Park Service Company*

---

[203] Tr. at 577.
[204] Ex. A-7 at 22-23.
[205] *Id.* at 23.
[206] *See, e.g.,* Decision No. 74437 (Aug. 18, 2014) at 10.
[207] *Id.*

decision: (1) that the Company provide an annual report on purchased power; and (2) that Commission Staff calculate an annual increase or decrease, and provide a Recommended Opinion and Order for Commission approval within 30 days of the Company's annual report.[208]

In accordance with the Commission's support of purchase power adjustors for water and wastewater utilities, Staff also recommends approval of the Company's request. For these reasons, the Company requests that the Commission approve its PCAM.

d. Health Care Cost Adjustor

Medical costs for employees continue to be a volatile and unpredictable component of the Company's expenses.[209] The volatility and unpredictability of these health care costs makes them appropriate for an adjustor mechanism. This mechanism would allow adjustment based on increases or decreases in medical costs for employees.[210] An adjustor mechanism would provide protection for both the Company and customers for changes in this expense item.[211]

As discussed in the testimony of Ms. Hubbard, medical costs are based on employee levels and also include some individual selection criteria.[212] An average cost per employee would be used to determine the known and measurable expense.[213] The Company recommends using the average cost per employee and the current employee count as the base and provide an adjustment when the average cost per employee changes.[214] Because the employee count would be limited to the number in the test year, it would provide the Company with an incentive to control increasing employee levels, which would ultimately reduce costs for customers.[215]

---

[208] *Id.*
[209] Ex. A-7 at 24.
[210] *Id.*
[211] *Id.*
[212] *Id.*
[213] *Id.*
[214] *Id.*
[215] *Id.*

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

e. Tubac Storage Tank

As part of its engineering report in this matter, Commission Staff has recommended that the Company be required to install an additional storage tank in the Tubac Water District.[216] The Company does not object to this requirement, but should be allowed to conduct a hydraulic study to ensure that the storage tank is sized correctly.[217]

Commission Staff also recommends that this docket be left open for the sole purpose of allowing the Company to include the new storage tank in rate base at the time that it is completed.[218] Commission Staff is also recommending that the Company be required to utilize its own funds for this storage tank (rather than debt) to ensure that it is done on time and correctly.[219] The Company supports these two recommendations in relation to the Tubac storage tank.

f. Declining Usage

Contrary to the position taken by RUCO, the Company's declining usage adjustment is based upon known and measurable impacts on revenues since the last rate case.[220] Both residential and non-residential customer classes show trends in declining usage and it is not unreasonable to expect further reductions in per customer usage in the future.[221]

The empirical data demonstrates that conservation-oriented rate designs are working.[222] And when, as here, this declining usage can be demonstrated, it is reasonable to include an adjustment to reflect the impact on future revenues. Recent events in California relating to water restrictions highlight the on-going trend toward water conservation, particularly in the West. The emphasis on conservation will likely cause it to increase, which means that historical trends may understate prospective declining usage.

---

216 Ex. S-1, Ex. MST-4.
217 Ex. A-5 at 5.
218 Tr. at 874, 887.
219 Tr. at 885-87.
220 Ex. A-29 at 1-2.
221 *Id.* at 2.
222 *Id.*

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

As noted above, uncertainties in CAP deliveries could also greatly impact usage and revenues. Staff, based on its review of the Company's data, concurs that a declining usage adjustment is appropriate.[223]

g. **Rate Design**

Although Commission Staff has properly adjusted its rate design to account for declining usage, EWAZ continues to oppose the rate design recommended by Commission Staff, which recovers a lesser portion of the revenue requirement from the monthly minimum charge.[224] Given that the majority of the Company's costs are fixed, rather than being driven by demand, adopting a rate design which recovers 30-40% of the revenue requirement from the monthly minimum nearly ensures the under-recovery of costs. The following chart shows the percentage of metered revenues that the Company's proposed rate design recovers from the monthly minimums as compared to that of Commission Staff:[225]

	Mohave Water	Sun City Water	Paradise Valley Water	Tubac Water
Company	45.41%	38.26%	28.68%	45.74%
Staff	41.95%	37.71%	28.35%	40.72%

Commission Staff's proposed tiered rates also make it extremely difficult, if not impossible, for EWAZ to achieve its authorized revenue requirement.[226] As Mr. Bourassa explained in detail, the risk of under-recovery is greatly exacerbated by Commission Staff's rate design.[227] The Company's proposed rate design, which will also appropriately incent conservation, recovers a smaller, and more appropriate, percentage of metered

[223] Ex. S-18.
[224] Ex. A-29 at Ex. TJB-1RJ.
[225] Company's Schedules, H Schedules; Staff's Schedules, H Schedules; *see also*, Ex. A-29, Ex. TJB-1RJ.
[226] Ex. A-27 at 14.
[227] *Id.*; Ex. A-29 at 13, 16, 19, 21.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

revenues from the highest commodity rate, whereas Commission Staff's proposed rate design recovers a greater percentage:[228]

	Mohave Water	Sun City Water	Paradise Valley Water	Tubac Water
Company	23.90%	14.69%	35.22%	34.90%
Staff	29.49%	16.73%	37.88%	42.60%

By way of example, the following table highlights the annual decrease in revenues that a 20% reduction in usage would cause based on both existing rates and proposed rates:

Annual Reduction in Revenues due to 20% Reduction in Usage		
	PRESENT RATES	PROPOSED RATES
Mohave Water	$(871,933)	$(1,007,970)
Paradise Valley	$(1,595,263)	$(1,687,691)
Tubac	$(73,777)	$(103,230)
Sun City	$(1,432,877)	$(1,515,776)
Total	$(3,973,850)	$(4,314,667)

Recently, in two water utility rate cases, the Commission recognized issues with Staff-proposed rate designs and the risk of under-recovery. In both of those cases, the Commission revised Commission Staff's recommended rate design by increasing the fixed charge.[229] In fact, in a very recent decision, the Commission rejected Commission Staff's proposed minimum monthly charge and adopted the utility's proposed minimum monthly charge, which sought to recover equal amounts from the minimum monthly charge and the commodity charge:

> We believe a rate design that would allow Park to generate 50 percent of its authorized revenue from the monthly usage charge and 50 percent from commodity charges

[228] Company's Schedules, H Schedules; Staff's Schedules; H Schedules.

[229] Decision No. 74391 at 11; Decision No. 74398 at 17-18.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

provides a steady, reliable revenue stream, but yet still allows customers to lower their water bills through conservation.[230]

The same issues that the Commission recognized in those cases exist in this case, but to an even greater degree. Accordingly, it is appropriate for the fixed charge to be at the levels recommended by the Company and appropriate for the Commission to adopt the Company's proposed tiers so that the Company will have greater revenue stability and an opportunity to earn its authorized return.

h. Miscellaneous Service Charges

The Company has proposed revisions to its miscellaneous service charges, which Commission Staff has supported.[231] The Company requests that the Commission approve these revisions to the tariffs for the districts in this proceeding.

i. Low Income Tariff

The Company is proposing a new low income tariff for the Tubac Water District, Paradise Valley Water District and Mohave Wastewater District.[232] The Company also seeks to continue its low income program for the Sun City Water District and the Mohave Water District. The Company has included the following amounts in the highest tier of the rate design for each of the water districts to allow the Company to recover amounts related to the Company's low income program: Tubac Water District ($0.5780), Paradise Valley Water District ($0.0120), Sun City Water District ($0.0210) and Mohave Water District ($0.0570).[233] The Company requests that the Commission include these amounts in its final rate design. Given the unique nature of the wastewater rate design, the Company has not included a specific amount related to the low income program in the Mohave Wastewater District. Rather, the Company requests that the Commission allow it to defer these amounts for the Mohave Wastewater District for recovery in the next rate case.

[230] Park Water Company Rate Case, Docket No. W-02353A-14-0323, Decision at 8 (ROO adopted at Apr. 14, 2015 Open Meeting).
[231] Ex. A-4 at 6-10; Ex. A-5 at 6; Ex. S-16 at 15-16.
[232] Ex. A-7 at 25-26.
[233] Company's Schedules, H-3 Schedules.

LEWIS ROCA ROTHGERBER
201 E. Washington St., Suite 1200
Phoenix, AZ 85004-2595

RESPECTFULLY SUBMITTED this 17th day of April, 2015.

LEWIS ROCA ROTHGERBER, LLP

Thomas Campbell
Michael T. Hallam
201 E. Washington Street
Phoenix, AZ 85004
(602) 262-5340
Attorneys for EPCOR Water Arizona, Inc.

ORIGINAL AND thirteen (13) copies of the foregoing hand-delivered this 17th day of April, 2015, to:

The Arizona Corporation Commission
Utilities Division – Docket Control
1200 W. Washington Street
Phoenix, Arizona 85007

Copy of the foregoing hand-delivered this 17th day of April, 2015, to:

Steve Olea
Utilities Division
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Dwight D. Nodes, Law Judge
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Janice Alward. Chief Counsel,
Legal Department
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Copy of the foregoing mailed and e-mailed this 17th day of April, 2015, to:

Robin Mitchell
Legal Department
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007
Rmitchell@azcc.gov

Daniel W. Pozefsky
RUCO
1110 W. Washington St., Suite 220
Phoenix, AZ 85007
dpozefsky@azruco.gov

Marshall Magruder
P.O. Box 1267
Tubac, AZ 85646-1267
marshall@magruder.org

Greg Patterson
WUAA
916 W. Adams, Suite 3
Phoenix, AZ 85007
gpatterson3@cox.net
jampat@q.com

Rich Bohman, President
Santa Cruz Valley Citizens Council
P.O. Box 1501
Tubac, AZ 85646
rtbnmbaz@aol.com

Delman E. Eastes
2042 E. Sandtrap Lane
Fort Mohave, AZ 86426
delman_eastes@yahoo.com

William F. Bennett
Legal Counsel
Paradise Valley Country Club
7101 N. Tatum Blvd
Paradise Valley, AZ 85253
edelano@paradisevalleycc.com

Robert J. Metli
Munger Chadwick, P.L.C.
2398 E. Camelback Rd, Suite 240
Phoenix, AZ 85016
rjmetli@mungerchadwick.com

Andrew M. Miller
Town Attorney
6401 E. Lincoln Drive
Paradise Valley, AZ 85253
amiller@paradisevalleyaz.gov

Albert E. Gervenack
14751 W. Buttonwood Drive
Sun City West, AZ 85375
agervenack@bmi.net

Jim Stark
Sun City Home Owners Association
10401 W. Coggins Drive
Sun City, AZ 85351
N743ks@cox.net

Jayne Williams

EXHIBIT A

EPCOR Water Arizona
Docket No. WS-01303A-14-0010

Accumulated Depreciation Example

Example - 2 assets were placed in service in 2009 and 2012. In 2014, the asset placed in service in 2009 is retired before the end of its useful life. At that time the UPIS and Accumulated Depreciation are reduced. The annual depreciation expense is also reduced. The Accumulated Depreciation balance is insufficient to offset the 2014 retirement creating a debit balance, but the remaining asset remains in service longer than its average service life which eventually provides for the full recovery of the assets.

Asset Number ONE Placed into Service 2009

Asset Number TWO Placed into Service 2012

Retire Asset ONE Prior to "normal" useful life

Asset Number ONE lasted 6 years while asset number TWO lasted 14 years. The GROUP of assets depreciated over an average of 10 years each (6+14)/2.

Line		2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	Total Recovery
1	YEAR>>>>	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	
2	**Utility Plant in Service (UPIS):**																			
3	Plant Additions	$ 180			200															
4	Plant Retirements						(180)													
5	Plant Balance (Ln 3 + Ln 4 + Prior Yr Balance)	$ 180	180	180	380	380	200	200	200	200	200	200	200	200	200	200	200	200	200	
6																				
7	**Accumulated Depreciation:**																			
8	Depreciation Expense @ 10% (Ln 19)	$ (18)	$ (18)	$ (18)	$ (38)	$ (38)	$ (20)	$ (20)	$ (20)	$ (20)	$ (20)	$ (20)	$ (20)	$ (20)	$ (20)	$ (20)	$ (20)	$ (20)	$ (10)	
9	Plant Retirements						$ 180													
10	Accumulated Depreciation Balance (Ln 8 + Ln 9 + Prior Yr Balance)	$ (18)	(36)	(54)	(92)	(130)	30	10	(10)	(30)	(50)	(70)	(90)	(110)	(130)	(150)	(170)	(190)	(200)	
11																				
12	Net Book Value (Rate Base) (Ln 5 + Ln 10)	$ 162	$ 144	$ 126	$ 288	$ 250	$ 230	$ 210	$ 190	$ 170	$ 150	$ 130	$ 110	$ 90	$ 70	$ 50	$ 30	$ 10	$ -	
13																				
14																				
15																				
16																				
17	**Calculation of Depreciation Expense:**																			
18	Average useful Life 10 years or 10% depreciation per year	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	
19	Depreciation Expense (Ln 5 X Ln 18)	$ 18	18	18	38	38	20	20	20	20	20	20	20	20	20	20	20	20	10	
20																				
21																				
22	Revenue Requirement @ 6.74% Rate of Return	$ 35.91	$ 33.92	$ 31.93	$ 69.83	$ 65.63	$ 45.42	$ 43.21	$ 41.00	$ 38.79	$ 36.58	$ 34.37	$ 32.16	$ 29.95	$ 27.74	$ 25.53	$ 23.32	$ 21.11	$ 10.00	$ 636.39

Accumulated Depreciation moves to a Debit Balance temporarily

EXHIBIT B

UNIFORM SYSTEM OF ACCOUNTS FOR CLASS A WATER UTILITIES

1996

NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

1101 Vermont Avenue NW
Washington, D.C. 20005
USA
Tel: (202) 898-2200
Fax: (202) 898-2213
www.naruc.org

$25.00

NATIONAL ASSOCIATION
OF
REGULATORY UTILITY
COMMISSIONERS

1996
Uniform System of Accounts
For
Class A
Water Utilities

Pursuant to action by the National Association of Regulatory Utility Commissioners, this System of Accounts is recommended to the Commissions represented in the membership of this Association for consideration and for adoption in their respective jurisdictions with such modifications only as they may deem necessary in the public interest.

ACCOUNTING INSTRUCTIONS

4. General - Accounting Period

Each utility shall keep its books on a monthly basis so that for each month all transactions applicable thereto, as nearly as may be ascertained, shall be entered in the books of the utility. Amounts applicable or assignable to specific utility departments shall be segregated monthly. Each utility shall close its books at the end of each calendar year unless otherwise authorized by the Commission.

5. General - Submittal of Questions

To maintain uniformity of accounting, utilities shall submit questions of doubtful interpretation to the Commission for consideration and decision.

6. General - "Item" Lists

List of "items" appearing in the texts of the accounts or elsewhere herein are for the purpose of more clearly indicating the application of the prescribed accounting. The lists are intended to be representative, but not exhaustive. The appearance of an item in a list warrants the inclusion of the item in the account mentioned only when the text of the account also indicates inclusion inasmuch as the same item frequently appears in more than one list. The proper entry in each instance must be determined by the texts of the accounts.

7. General - Extraordinary Items

It is the intent that net income shall reflect all items of profit and loss during the period with the sole exception of prior period adjustments as described in Accounting Instruction 8. Those items related to the effects of events and transactions which have occurred during the period and which are not typical or customary business activities of the company shall be considered extraordinary items. Commission approval must be obtained to treat an item as extraordinary. Such request must be accompanied by complete detailed information (See accounts 433 and 434).

8. General - Prior Period Items

A. All prior period adjustments to retained earnings shall be approved by the Commission. Generally the only type of transactions which will be considered as a prior period adjustment are:

(1) Correction of an error in the financial statements of a prior period; or

(2) Adjustments that result from realization of income tax benefits of preacquisition loss carry forwards of purchased subsidiaries.

B. Prior period adjustments, when approved, shall be charged or credited to account 439 - Adjustments to Retained Earnings, and are not considered in income of the period. Prior period adjustments shall be recorded net of all state and federal income tax effects.

C. Changes in depreciation or amortization estimates or methods are considered changes in accounting estimates rather than accounting errors; and therefore are not subject to prior period adjustments. Any adjustments made to the accumulated amortization or depreciation balances of the utility due to a change in estimate or method shall be offset by a charge or credit to either: an income account; account 186.2 - Other Deferred Debits; or account 253 - Other Deferred Credits, as directed by the Commission.

9. <u>General - Unaudited Items</u>

Whenever a financial statement is required by the Commission, if it is known that a transaction has occurred which affects the accounts but the amount involved in the transaction and its effect upon the accounts cannot be determined with absolute accuracy, then the amount shall be estimated and such estimated amount included in the proper accounts. A complete description of the transactions shall accompany the financial statement. Utilities are not required to anticipate minor items which would not appreciably affect the accounts.

10. <u>General - Allocation of Salaries and Expenses of Employees</u>

Charges to utility plant or to a salaries expense account shall be based upon the actual time engaged in either plant construction or providing operation services. In the event actual time spent in the various activities is not available or practicable, salaries should be allocated upon the basis of a study of the time engaged during a representative period. Charges should not be made to the accounts based upon estimates or in an arbitrary fashion.

11. <u>General - Payroll Distribution</u>

Underlying accounting data shall be maintained so that the distribution of the costs of labor charged to the various accounts will be available. The utility may utilize clearing accounts in its accounting process; however, the use of clearing accounts does

B. Work orders shall be cleared from this account as soon as practicable after completion of the job. Further, if a project, such as pumping station or treatment plant, is designed to consist of two or more units which may be placed in service at different dates, any expenditures which are common to and which will be used in the operation of the project as a whole shall be included in utility plant in service upon the completion and the readiness for service of the first unit. Any expenditures which are identified exclusively with units of property not yet in service shall be included in this account.

C. Expenditures on research and development projects for construction of utility facilities are to be included in a separate subdivision in this account. Records must be maintained to show separately each project along with complete detail of the nature and purpose of the research and development project together with the related costs.

106. Completed Construction Not Classified

At the end of the year or such other date as a balance sheet may be required by the Commission, this account shall include the total of the balances of work orders for utility plant which has been completed and placed in service but which work orders have not been classified for transfer to the detailed utility plant accounts.

Note:--For the purpose of reporting to the Commission, the classification of utility plant in service by accounts is required. The utility shall also report the balance in this account tentatively classified as accurately as practicable according to prescribed account classifications. The purpose of this provision is to avoid any significant omissions in reported amounts of utility plant in service.

108. Accumulated Depreciation

A. This account shall reflect the depreciation accumulated on plant used in water utility service.

B. The utility shall maintain separate subaccounts corresponding with the depreciable plant accounts, in which the accumulated depreciation total is segregated.

C. The following subaccounts shall be maintained:

108.1 Accumulated Depreciation of Utility Plant in Service

A. This account shall be credited with the following:

BALANCE SHEET ACCOUNTS

(1) Amounts charged to account 403 - Depreciation Expense, to account 416 - Costs and Expenses of Merchandising, Jobbing and Contract Work, or to clearing accounts for current depreciation expense (excludes contributed plant).

(2) Amounts of depreciation applicable to utility properties acquired as operating units or systems (See Accounting Instruction 21).

(3) Amounts charged to account 182 - Extraordinary Property Losses, when authorized by the Commission.

(4) Amounts equal to those concurrently charged to account 272 - Accumulated Amortization of Contributions in Aid of Construction, if such amortization is recognized by the Commission.

Note:--See Accounting Instruction 8 and account 439 regarding adjustments for past accrued depreciation.

B. At the time of retirement of depreciable utility plant in service, this account shall be charged with the book cost of the property retired plus the cost of removal, and shall be credited with the salvage value and any other amounts recovered, such as insurance. When retirement, cost of removal and salvage are entered originally in retirement work orders, the net total of such work orders may be included in a separate sub-account hereunder. Upon completion of the work order, the proper distribution to subdivisions of this account shall be made as provided in the following paragraph.

C. When transfers of plant are made from one utility plant account to another, or from or to another utility department, or from or to nonutility property, the accounting for the related accumulated depreciation shall be as provided in Accounting Instruction 29.

D. The utility is restricted in its use of this accumulated depreciation account to the purposes set forth above. It shall not divert any portion of this account or make any other use thereof without authorization by the Commission.