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ARIZONA CORPORATION COMMISSION
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8 **ORIGINAL**

9 **BEFORE THE ARIZONA CORPORATION COMMISSION**

10 **COMMISSIONERS**

11 SUSAN BITTER SMITH, CHAIRMAN
12 BOB STUMP
13 BOB BURNS
14 TOM FORESE
15 DOUG LITTLE

Arizona Corporation Commission
DOCKETED

APR 20 2015

DOCKETED BY 

16 IN THE MATTER OF THE APPLICATION
17 OF UTILITY SOURCE, LLC, AN
18 ARIZONA CORPORATION, FOR A
19 DETERMINATION OF THE FAIR VALUE
20 OF ITS UTILITY PLANTS AND
21 PROPERTY AND FOR INCREASES IN
22 ITS WATER AND WASTEWATER RATES
23 AND CHARGES FOR UTILITY SERVICE
24 BASED THEREON.

DOCKET NO: WS-04235A-13-0331

POST-HEARING RESPONSE

25 Utility Source, L.L.C. (“Company” or “Utility Source”), hereby files its post-
26 hearing response (“Response”). The Response hereby incorporates the Company’s Final
27 Schedules filed with the Arizona Corporation Commission (“Commission”) on March 6,
28 2015, and the Company’s Post-Hearing Brief filed on March 24, 2015. In the post-
hearing briefs, none of the parties raised new arguments that Utility Source has not
already addressed; therefore, the Company will only address the central arguments in this
case. Utility Sources’ positions have not changed on any issue.

1 **1.0 Preliminary Statement**

2 First, it is important to know that at no time have the owners of Utility Source
3 taken a dividend despite substantial investment into the Company, nor have the owners of
4 Utility Source ever taken a salary despite having dedicated a substantial amount of time
5 working on Company matters. McCleve Testimony at p. 768, lines 20-23. Between
6 2006 and 2013, the Company has lost \$1,395,000. *Id.* at p. 767, lines 19-20. With that in
7 mind, the suggestion or intimation by certain parties that the Company’s owners are
8 somehow unduly enriching themselves at the customers’ expense is demonstratively
9 wrong. Point in fact – it is undisputed that the owners of Utility Source have given
10 substantial amounts of money each year to pay the operating expenses of the Company.
11 *Id.* at p. 768, lines 11-19.

12
13 As Staff notes, there are no material disputes between Staff and the Company
14 regarding rate base or expense issues. Staff Post-Hearing Brief, at p. 2, line 14. The
15 primary dispute between Staff and the Company relates to Staff’s proposed novel
16 ratemaking approach that tries to interject potential revenues into a test year that occurred
17 two years earlier. The Company believes that Staff’s approach is a radical departure
18 from normal ratemaking practices and puts the Company at risk. The Company also
19 believes its cost of capital is 11% rather than the 9.8% as proposed by Staff.
20 Furthermore, the Company’s rate designs are more reasonable.

21 At the same time, the RUCO, Nielsen, and Fallon (“Intervenors”) propose
22 numerous adjustments to the rate base and expenses that are both unwarranted and
23 without factual support. The court should disregard these proposals and adopt the
24 Company’s proposed rates.

25 **2.0 Staff’s Standpipe Proposal**

26 The central disagreement between the Company and Staff relates to the new
27 standpipe operation. Staff’s proposal can only be described as creative ratemaking based
28 on fiction, not fact. First, Staff takes one water system and splits it into two parts with

1 the standpipe being “the new system”. Second, Staff then proceeds to take a substantial
2 portion of the existing plant – already determined used and useful to serve the existing
3 community – and makes the assumption that it is dedicated to “the new system”. This
4 includes 25% of pipelines and 30% of Deep Well 4, as well as an estimated cost of the
5 standpipe cost. Staff’s percentage allocations are based upon conjecture of what sales
6 may be in the future. In other words, Staff is allocating plant determined to be both used
7 and useful long before the standpipe was built to its “standpipe customer rates” and
8 guessing at the amount of revenues to be generated.

9
10 As if the rate base conjecture was not enough, Staff proposes to shift actual
11 expenses incurred during the test year to the new system. Staff is moving depreciation
12 expense, power costs, chemical costs, and 25% of operating expenses to the new system.
13 Stated otherwise, Staff is assuming that operating expenses legitimately incurred to serve
14 customers in 2012 will disappear because new standpipe customers will be added.

15 This approach is completely nonsensical. How can it be supported, with a straight
16 face, that adding more customers will reduce the Company’s operating expenses by 25%?
17 How can 25% of a water system currently being used to serve a community suddenly be
18 removed from the rate base for the reason that the Company is going to serve more
19 customers? Attempting to answer these questions simply confirms how far from standard
20 rate making Staff has strayed.

21 On the other hand, if customary procedures are followed and Staff still wants to
22 latch onto the projected standpipe revenues, then the investments of \$1.5 million in Deep
23 Well 4 and \$165,000 in standpipe station construction must also be included in rates. *See*
24 *Bourassa Testimony* at p. 145. Unfortunately should that action be taken, it would be
25 detrimental to the customers. The customer’s rates would increase substantially in
26 contrast to what the Company now proposes.

27 Finally, Staff states that no other party offered a solution, which is not true. The
28 Company has a very reasonable approach, which is to follow normal ratemaking

1 practices and keep the standpipe and its projected revenues out of the rate case. Under
2 the Company's proposal, if the Company "overearns" by exceeding the revenue
3 requirement by 10% or more, then it will file another rate case. The Company is
4 confident it will not "overearn" even with substantial standpipe revenue because the rate
5 increase will likely cause the customers to reduce water consumption, which will reduce
6 revenues. Nevertheless, if Company overearning is what actually concerns Staff, then
7 this proposal solves the problem.

8 **3.0 Rate Base Adjustments**

9 Under Arizona law, the Commission's decision in Decision No. 70140 and the rate
10 base determined therein must be respected. See A.R.S. § 40-252; see also *Cox v.*
11 *Mackenzie*, 70 Ariz. 308, 219 P.2d 1048, 1051 (1950). Both Staff and the Company are
12 following the law and therefore agree upon rate base. Staff Post-Hearing Brief, at p. 2,
13 line 14. Both parties have removed plant no longer used, such as the shallow wells, and
14 added plant where appropriate.

15 Unfortunately, Intervenors have spent countless hours arguing that the previous
16 Commission decision was wrong and essentially should be overturned. They want this
17 Court to revisit the rate base and reappraise the land values, reclassify fire hydrants as
18 CIAC, reclassify transmission lines, and remove more than \$550,000 from rate base
19 under the premise that the money was actually gained from customers through hook-up
20 fees. Effectively, they allege that the Commission wrongly determined these assets were
21 owner investment rather than CIAC.

22 Even if the court set aside the law and gave weight to these arguments, the
23 Intervenors fail to provide any proof that the Commission erred in Decision No. 70140.
24 Instead, they argue that the Company has the burden of establishing the entire rate base
25 once again. The logical extension of their argument is that every time a utility seeks a rate
26 increase, it has to prove up its entire rate base, even those assets that were previously
27 adjudicated. Clearly, this is not the law, nor is it even practical. Consistent with the
28

1 Company's position, Staff's witness repeatedly explained to Nielsen that during the rate-
2 making process, balances that were approved in the prior rate case are carried forward.
3 *See, e.g.,* Thompson's Testimony at p. 758 – p. 760. Accordingly, Intervenor's proposed
4 adjustments to rate base established in the last rate case should be rejected.

5 **3.1 Small Treatment Plant**

6 The Company, Staff, and RUCO all agree that using the small treatment plant to
7 hold and treat sludge is useful and the plant should remain in rate base. Staff's engineer
8 testified that using the plant to decompose and dry sludge is useful. *See* Thompson
9 Testimony at p. 555, lines 20-21. Meanwhile, Nielsen believes this plant is not useful
10 because it is not being used as influent treatment. Unfortunately, Nielsen fails to
11 understand that hauling wet sludge to a disposal facility would be much more expensive
12 and using the plant in this manner saves the Company and ratepayers substantial amounts
13 of money on hauling costs. Thompson's Testimony at p. 569, line 2 – p. 570, line 8.
14 Therefore, the Company's position should be adopted.

15 **3.2 Deep Wells 1 and 3**

16 Utility Source owns Deep Well 1 (55-593267) and Deep Well 3 (55-203241).
17 This can be independently verified through the Arizona Department of Water Resources'
18 Water Well Registry Data Base.¹ Nevertheless, Nielsen argues that Utility Source needs
19 to acquire the land to put these wells in rate base. This position is both wrong and would
20 be financially irresponsible of the Company. Leasing the well sites makes sense. The
21 subject property is extremely valuable and purchasing the land would increase rate base
22 far beyond what is necessary.

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28 ¹ <https://gisweb.azwater.gov/WellRegistry/SearchWellReg.aspx>

1 **4.0 Operating Expense Adjustments**

2 **4.1 Alleged Comingling of Businesses**

3 Intervenor's make numerous reductions in Company expenses based upon the
4 unsupported allegation that much of the office work is dedicated to supporting numerous
5 other businesses. They assert the court should reduce expenses related to employees,
6 transportation, copying machines, telephones, and essentially all office-related expenses.
7 As stated, this allegation is false and unsupported by the record.

8
9 As the Company explained, Utility Source uses a small office space owned by
10 Lonnie McCleve. McCleve Testimony at p. 133, lines 16-24. The office is in the
11 gatehouse to The Pecans, a gated community. This gatehouse is primarily dedicated
12 office space for Utility Source. However, because there is no open access to The Pecans
13 community, as a courtesy, Utility Source allows realtors to leave marketing pamphlets
14 and cards at the gatehouse for people who are interested in purchasing a lot in the Pecans.
15 Also as an accommodation, the Company allows realtors to use the office to meet
16 potential home buyers mostly on weekends. The gatehouse is not used as an office to sell
17 homes. McCleve Testimony at p. 98, lines 3-6. Similarly, the Company allows the
18 Pecans HOA board to meet in the conference room when it is not being used by Utility
19 Source. McCleve Testimony at p. 38, lines 11-21; p. 122, lines 15-21. When asked if
20 Utility Source shares the office space with anybody, McCleve definitely testified "no".
21 *Id.* at p. 38, lines 11-12.

22 Intervenor's also try to support their position by noting that approximately seven
23 other businesses list the gatehouse as their address and that their contact telephone
24 number is the same number used by McCleve and Parry to operate Utility Source. As
25 McCleve explained, these other companies are primarily sole project companies that hold
26 an individual piece of property and he uses the gatehouse, rather than his home, as his
27 contact business address. McCleve Testimony at p. 122, lines 4-14. When asked about
28 the other business activities, Staff's witness also testified "the clubhouse may be used as

1 a mail drop, as a mailing address, but I'm not aware that there's substantial business
2 conducted in the office." Keller Testimony at p. 763, lines 12-25. Similarly, McCleve
3 and Parry have to provide contact phone numbers for these companies, and it stands to
4 reason that they would simply provide their current telephone numbers, which also
5 happens to be the same numbers used to conduct Utility Source business.

6 Ms. Parry is Utility Source's only office employee. As McCleve testified, a vast
7 majority of her time is spent on Utility Source business. McCleve Testimony at p. 74,
8 lines 1-11. She performs all of the office work for both the water and wastewater
9 divisions. As Staff witness Keller testified, "I think that a company of this revenue and
10 connections would need to have one full-time bookkeeper and that's ... what I
11 calculated." Keller Testimony at p. 757 lines 7-9.

12 Ms. Parry also runs all of the Company errands, such as banking and gathering
13 supplies, using her own vehicle. McCleve Testimony at p. 79, lines 4-13. Therefore, the
14 Company pays her an extra \$500 a month (*id.*), which is clearly less expensive than the
15 Company purchasing, insuring, and maintaining a vehicle. While Ms. Parry does serve
16 as the secretary of the Pecans HOA and will direct interested home buyers to realtors,
17 these tasks are incidental to her primary work as the office manager of Utility Source. As
18 Staff recognizes, performing all of the office work for a utility providing both water and
19 wastewater service is a full-time job. To think that Ms. Parry is spending most of her
20 time working for the HOA and property holding companies defies logic.

21 **4.2 Rent Payment.**

22 Intervenor seems to argue no rent expense should be allowed because the
23 Company paid McCleve's residential electric bill in lieu of rent. Admittedly, this was an
24 unorthodox method, but it was less expensive than paying market rate for office space
25 and resulted in a savings for the customers. Staff agrees that the reclassification of this
26 expense as rent is reasonable and should be adopted.
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1 **4.3 Power Expense for Deep Well 4**

2 As the court knows, the Company did not seek to include Deep Well 4 into rate
3 base because it would drive the customer rates even higher; however, the Company did
4 seek recovery of the pumping cost associated with Deep Well 4. As explained, this
5 pumping resulted in water production and Deep Well 4 is needed as a backup supply, so
6 the pumps must be exercised. See Bourassa Testimony at p. 153, lines 2-25. Thus, this
7 expense should be recognized.

8 **4.4 Summary of Operating Expenses**

9 The court should reject the Intervenors' arguments related to operating expenses
10 because they are neither accurate nor supported by the record. Based upon the evidence,
11 with a few minor adjustments, Staff and the Company agree on operating expenses.
12 Accordingly, the court should adopt the position of the Company.

13 **5.0 Rate Design**

14 The Company continues to support its water rate design. These rates offer the
15 Company rate stability while encouraging conservation. Specifically regarding the
16 wastewater division rates, the Company's design is patterned after the rate design in the
17 previous rate case and should be adopted. Residential rate design is critical because the
18 Company has 320 residential customers and 4 commercial customers. For the typical
19 residential customer, the Company proposes a \$52.00 minimum and \$4.96 per 1,000
20 gallons of water use per month. This will provide the Company revenue stability and
21 retain the link to water use as Staff has historically wanted

22 **6.0 Cost of Capital**

23 No party raised new arguments in their post-hearing briefs and the Company
24 maintains that a cost of equity of 11% based on recent analyses is reasonable. As
25 Company expert Bourassa established, a return on equity of 11.0% for Utility Source,
26 given its size and greater risk compared to the public traded water utilities, is
27 conservative. The Company's recommended capital structure consists of no debt and
28

1 100% common equity. Based on the Company's recommended cost of equity and capital
2 structure, the Company's weighted cost of capital is 11.0%, as shown in Exhibit A-1,
3 Rejoinder Schedule D-1.

4 The Company's position recognizes the significant business and investment risk
5 facing small utilities like the Company. See Bourassa Testimony at p. 156, line 7 – p.
6 158, line 2. As Bourassa noted, small utility companies often fail to earn their authorized
7 rate of return when compared to large utilities. *Id.* at p. 158, lines 3-11. Therefore,
8 Bourassa recommends a 70 point adjustment to recognize the fact that small utilities face
9 far more risk than large utilities and the Commission should recognize this fact. See
10 Bourassa Testimony at p. 782, line 8 – p. 783, line 13.

11 Staff and RUCO, however, purport to treat small utilities like a large company or
12 worse. It is well known that, unlike a large company, a small company cannot sell bonds
13 and there is no dispute that banks typically do not loan money to small water companies
14 in Arizona. See, e.g., Mease Testimony a p. 506, line 11 – p. 507, line 16; Cassidy
15 Testimony at p. 601, line 6 – p. 602, line 15. Further, small water companies, like Utility
16 Source, do not have access to the publicly traded equity markets. This means it is
17 extremely difficult for small water companies to raise capital, which increases their risk.
18 More importantly, large utility market returns for the last 1-year, 3-year, and 5-year
19 periods range from approximately 12.6% to 11.8%. Bourassa Testimony at p. 784, lines
20 19-23. These large company returns are much higher than those proposed by Staff and
21 RUCO.

22 Both Staff and RUCO actually had to make substantial adjustments to their models
23 to raise their recommendations because the results from their models were far too low.
24 Staff's models initially produced such a low number that Staff had to add an "economic
25 assessment adjustment" of 60 basis points to reach its final number. See Cassidy
26 Testimony at p. 614, line 24 – p. 615, line 18. Similarly, RUCO's proposed cost of
27 capital of 9.25% includes a 70 point upward adjustment. Again, this is because the
28

1 models RUCO used produced a result that was far too low. See Mease Testimony at p.
2 508, line 20 – p. 509, line 16.

3 Thus, the Company's models produced a 10.3% result that was below the earnings
4 of large companies, and when the Company added 70 basis points, the rate of return was
5 still below, but near the large company earnings. Meanwhile, both Staff and RUCO used
6 models that produced unreasonably low numbers, so they made 60 and 70 basis point
7 adjustments to make their recommendations appear more realistic. Despite their efforts,
8 clearly the Company's models are more accurate and its recommendation is the most
9 reasonable.
10

11 **7.0 Miscellaneous Issues**

12 **7.1 Rate Case Expenses.**

13 Consistent with Staff's position, the Company has agreed to a 5 year annualized
14 period for rate case expense.

15 **7.2 BMPs**

16 The Company still opposes any requirement to adopt BMPs.

17 **7.3 Deep Well 4**

18 There is no need to add additional restrictions to Deep Well 4. The Company has
19 no intention of selling this well and left it out of rate base only to save the customers from
20 paying higher rates. Further, the Company has no intention of requiring a future
21 developer to drill another well unless the projected development water demand exceeds
22 the current capacity of the Company.

23 **7.4 Engineering Analysis**

24 There is no need to require the Company to spend money on an engineering study.
25 The fire flow issues have been remedied and as Staff notes in its standpipe analysis, the
26 existing system with Deep Well 4 is able to meet the current water demand.

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