ORIGINAL

0000161848

BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

2015 SEP 18 P 2:14

AZ CORP COMMISSION
DOCKET CONTROL

COMMISSIONERS

SUSAN BITTER SMITH, Chairman
BOB STUMP
ROBERT BURNS
DOUG LITTLE
TOM FORESE

IN THE MATTER OF THE APPLICATION OF CHINO MEADOWS II WATER CO., INC. FOR A RATE INCREASE.

DOCKET NO. W-02370A-14-0231

NOTICE OF FILING REJOINDER TESTIMONY

Chino Meadows II Water Co., Inc. ("Chino Meadows") hereby provides notice of filing its rejoinder testimony in the above-captioned case.

Respectfully submitted on September 18, 2015, by:

Craig A. Marks

Craig A. Marks
Craig A. Marks, PLC
10645 N. Tatum Blvd
Suite 200-676
Phoenix, Arizona 85028
(480) 367-1956
Craig.Marks@azbar.org
Attorney for Chino Meadows II Water Company

Original and 13 copies filed
on September 18, 2015, with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Arizona Corporation Commission
DOCKETED
SEP 18 2015
DOCKETED BY TV

Copies mailed on September 18, 2015 to:

Bridget A. Humphrey/Matthew Laudone
Staff Attorneys
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

SUSAN BITTER SMITH, Chairman
BOB STUMP
BOB BURNS
DOUG LITTLE
TOM FORESE

IN THE MATTER OF THE APPLICATION OF CHINO MEADOWS II WATER COMPANY, INC. FOR APPROVAL OF A RATE INCREASE	DOCKET NO. W-02370A-14-0231

REJOINDER TESTIMONY
OF
RAY L. JONES
ON BEHALF OF
CHINO MEADOWS II WATER COMPANY, INC.
SEPTEMBER 18, 2015

REJOINDER TESTIMONY
OF
RAY L. JONES
ON BEHALF OF
CHINO MEADOWS II WATER COMPANY, INC.
September 18, 2015

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Mr. Jones responds to the surrebuttal testimony of the Arizona Corporation Commission's Utilities Division Staff. Mr. Jones addresses the allocation of costs between Chino and Granite and Staff's failure to incorporate changes to expense recommendations into the revenue requirement of the Company.

The Company's proposed revenue requirements, associated rate increases and all other positions are unchanged from its rebuttal testimony.

I INTRODUCTION

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND TELEPHONE NUMBER.

A. My name is Ray L. Jones. My business address is 18835 North Thompson Peak Parkway, Suite 215, Scottsdale, AZ 85255, and my business phone is (623) 341-4771.

Q. ARE YOU THE SAME RAY L. JONES WHO PREVIOUSLY SUBMITTED REBUTTAL TESTIMONY IN THIS DOCKET??

A. Yes.

II RESPONSE TO STAFF'S SURREBUTTAL TESTIMONY

Q. HAVE YOU REVIEWED STAFF'S SURREBUTTAL TESTIMONY IN THIS CASE?

A. Yes, I reviewed the testimony provided by Teresa B. Hunsaker.

Q. WHAT WAS YOUR OVERALL ASSESSMENT OF STAFF'S SURREBUTTAL TESTIMONY?

A. It is evident that Staff reviewed the Company's rebuttal testimony and considered the Company's positions and concerns. In fact, Staff's surrebuttal position has incorporated some of the Company's suggestions and includes movement on the Company's most significant issue, cost allocation between Chino and Granite. However, Staff failed to update Chino's recommended revenue requirement to reflect its revised allocations. Inexplicably, Staff's revenue requirement remains unchanged from Staff's direct testimony.[1]

---

[1] This is even more inexplicable because Staff does incorporate the reduction in expenses for Granite resulting from the updated allocation of costs into a reduced revenue requirement for Granite.

In the end, Staff's surrebuttal testimony is nothing more than a collection of seemingly reasonable responses to the Company's rebuttal position—actually wholly ignored—which ultimately produce the absurd outcome where Staff's seemingly reasonable response leave the combined operations of Chino and Granite worse off than if Staff had not "updated" its position.

Q. WOULD YOU EXPLAIN?

As more fully explained in the Company's rebuttal testimony, the Company's most significant overall concern is the allocation of common costs between Chino and Granite. The Company has historically allocated costs based on customer counts, which are currently 88% Chino 12% Granite.[2] Staff's direct position, allocating only 70.12% of costs to Chino and 26.93% to Granite, dramatically shifted a very significant $49,006 in costs and related revenue from Chino.[3] The Company was concerned with this shift because Granite has fewer customers, lower water sales, higher levels of plant investment and higher rates. Shifting costs to Granite would create revenue instability for the water companies as a whole. Since Granite's water sales are only 15.5% of the combined total sales for Chino and Granite, each $10,000 shift in costs lowers rates for Chino by about $0.25 per 1,000 gallons while increasing rates in Granite by about $1.06 per 1,000 gallons. Due to this disparate impact to rates, aggressive shifting of costs to Granite is certain to increase revenue instability because Granite would almost certainly under-collect its authorized revenue by a significant magnitude.

---

[2] Antelope Lakes has only 2 customers equaling 0.20% of total combined customers.

[3] Staff's cost allocation recommendation shifts $40,921 in costs to Granite and $8,096 in costs to Antelope Lakes as compared to the Company's current customer based allocation. This testimony will only address the shift to Granite. See the Company's rebuttal for discussion of the negative impacts of shifting costs to Antelope Lakes.

Staff has responded to the Company's concerns by altering its cost allocation model to allocate more costs to Chino and fewer to Granite. Staff's current recommendation is 74% to Chino and 25% to Granite. This recommendation results in an additional $10,634 in expense allocated to Chino compared to Staff's original recommendation. This, on its face, appears to at least partially address the Company's cost allocation concerns. However, because Staff failed to increase Chino's revenue requirement to recover these additional expenses, neither Chino nor Granite will be able to recover these expenses. So instead of Granite being unlikely to recover $10,634 in common expenses, Staff would instead guarantee that neither Granite nor Chino would recover these $10,634 in common expenses. The net effect of Staff's incomplete allocation would make the combined operations of Chino and Granite are worse off.

Q. HOW SHOULD THE COMMISSION RESOLVE THIS PROBLEM?

A. The Commission should adopt the Company's more balanced, simplified approach to cost allocation. The Company's recommendation is a significant, yet reasonable, shift from the current customer based allocation. The Company's recommendation is an allocation of 80.5% to Chino and 19.5% to Granite. This recommendation shifts a still significant $20,556 in costs to Granite, addressing Staff's cost allocation concerns, while still providing both Chino's and Granite a reasonable opportunity to recover the common costs related to the operation of both companies.

Furthermore, this cost allocation must be incorporated into updated revenue requirement for Chino by setting Chino's revenue requirement using a 15% operating margin as recommended by the Company. As explained in the Company's application:

> Chino Meadows has a small and declining rate base due to the age of plant facilities, and the above-discussed mismatch between historically recorded depreciation expense and actual plant depletion. For a company with a very small rate bases, traditional ratemaking may yield inadequate Operating Income, which

provides a dangerously small margin over expenses. A company with inadequate Operating Income may find it difficult or even impossible to cover increasing or fluctuating costs, to deal with emergencies or other contingencies, and to attract new capital for system improvements.

In Chino Meadow's case, traditional rate making would result in an Operating Margin of only 4.16%, assuming a 10.0% return on rate base. This is well below the Operating Margins the Commission typically provides companies with small or negative rate bases. Therefore, Chino Meadows has calculated a revenue requirement based on an Operating Margin of 15.0%, consistent with the California PUC policy for small water utilities (less than 2,000 customers). This approach is also consistent with past Commission Decisions for small companies with small or negative rate base.

Q. WHY IS THIS COST ALLOCATION ISSUE IMPORTANT TO CHINO AND GRANITE?

A. Chino and Granite are both small companies facing the numerous challenges and issues faced by small companies throughout Arizona. Like other small water companies, Chino and Granite need to be properly positioned for consolidation and, until that can occur, they need to remain viable and have sufficient earnings to encourage investment in infrastructure.

Chino has increased rates by less than one percent over the past 20 years and is only requesting a modest increase in this case. In contrast, Granite is attempting to recover significant investment in new plant and is facing a large rate increase. Staff proposes to keep Chino rates unchanged by significantly shifting costs to Granite. Both Chino and Granite need sufficient revenue to allow for future improvements and attract new investment into their water systems.

The abrupt cost shift from Chino to Granite proposed by Staff will destabilize the revenue of both companies, further reduce the common operation's ability to cover its common expenses, and further harm the operations of both Chino and Granite. Ultimately, the proposed cost shift could impair the Companies' ability to implement the operational improvements desired by Staff and committed to by the Companies.

Lastly, Staff's proposal moves the companies contrary to industry trends. The Commission and industry are exploring ways to encourage consolidation and to make it easier for small water companies to be acquired by larger, better capitalized companies. Even California has taken steps to improve the financial health of its small water companies and make them more attractive for new investment. Unfortunately, the cost shift embedded in Staff's recommendation runs contrary to these Commission, industry, and neighboring-state regulatory policies.

Q. HAS THE COMPANY UPDATED ITS POSITION FROM ITS REBUTTAL TESTIMOMY?

A. The Company's position is unchanged.

Q. WHAT ARE THE CURRENT AREAS OF DISAGREEMENT BETWEEN STAFF AND THE COMPANY?

A. The Company opposes Staff Rate Base Adjustment No. 1 removing 10% of the cost of $42,759 of plant in service from rate base by increasing the Company's CIAC balance by $4,276.

The Company and Staff have minor differences in their approach to the calculation of amortization of CIAC related to Staff Rate Base Adjustment No. 2.[4] The Company uses an approach based solely on composite depreciation rates while Staff uses a more complex approach mixing composite rates and account specific rates to calculate CIAC

---

[4] The Company's concern would also apply to Staff Rate Base No. 1 if adopted by the Commission.

amortization. The Company recommends using only composite depreciation rates consistent with normal Commission practice and past Commission orders for the Company. The Company believes that the added complexity is unnecessary and will lead to confusion and disagreement regarding future CIAC amortization balances.

There are three areas of disagreement between the Company and Staff regarding expenses. First, as discussed above, the Company and Staff are recommending different allocation percentages between Chino and Granite. Second the parties disagree on the salary level of Mr. Levie. Lastly the Company and Staff propose differing levels of depreciation expense due to the differing levels of CIAC (Rate Base Adjustment No. 1) and minor differences in CIAC amortization calculation methodology.

The Company and Staff are in agreement regarding the methodology for calculating the level of working capital, property tax expense and income tax expense. However, since the Company and Staff disagree on their revenue and expense recommendations the specific recommendations for these items are different.

The parties have not altered their positions on the recommended code of conduct and related recommendations. Accordingly, several additional items remain in dispute.

Q. DOES THIS CONCLUDE YOUR REJOINDER TESTIMONY?

A. Yes.