ORIGINAL

OPEN MEETING ITEM

0000163978

COMMISSIONERS
SUSAN BITTER SMITH - Chairman
BOB STUMP
BOB BURNS
DOUG LITTLE
TOM FORESE

ARIZONA CORPORATION COMMISSION

AZ CORP COMMISSION
DOCKET CONTROL

2015 AUG 24 PM 2 53

DATE: AUGUST 24, 2015

DOCKET NO.: WS-04235A-13-0331

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Scott M. Hesla. The recommendation has been filed in the form of an Opinion and Order on:

UTILITY SOURCE, LLC
(RATES)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00** p.m. on or before:

SEPTEMBER 2, 2015

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

SEPTEMBER 8, 2015 AND SEPTEMBER 9, 2015

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602) 542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

Arizona Corporation Commission
DOCKETED
AUG 24 2015
DOCKETED BY

Jodi A. Jerich

JODI JERICH
EXECUTIVE DIRECTOR

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 UTILITY SOURCE, LLC, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANTS AND PROPERTY AND FOR INCREASES IN ITS WATER AND WASTEWATER RATES AND CHARGES FOR UTILITY SERVICES BASED THEREON.	DOCKET NO. WS-04235A-13-0331 DECISION NO. ____________ **OPINION AND ORDER**

DATES OF HEARING:	November 12, 2013 (Procedural Conference); July 15, 2014 (Procedural Conference); August 19, 2014 (Public Comment); November 13, 2014 (Pre-Hearing Conference); November 18, 2014 (Procedural Conference); February 17, 18, and 19, 2015 (Evidentiary Hearing)
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Scott M. Hesla[1]
APPEARANCES:	Mr. Steve Wene, MOYES SELLERS & HENDRICKS LTD, on behalf of Utility Source, LLC; Mr. Daniel W. Pozefsky, on behalf of the Residential Utility Consumer Office; Mr. Terry Fallon, in propria persona; Mr. Erik A. Nielsen, in propria persona; and Mr. Wesley Van Cleve and Mr. Matthew Laudone, Staff Attorneys, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

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[1] Administrative Law Judge Sarah N. Harpring was initially assigned to this case and she held the procedural conferences occurring on November 12, 2013 and July 15, 2014, and the public comment session occurring on August 19, 2014.

BY THE COMMISSION:

* * * * * * * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

I. PROCEDURAL HISTORY

1. On September 27, 2013, Utility Source, LLC ("Utility Source" or "Company") filed with the Arizona Corporation Commission ("Commission") an application for a determination of the current fair value of its utility plants and property and for increases in its rates and charges for water and wastewater utility services provided to customers in the Company's service area in Coconino County, Arizona. Utility Source's application uses a test year ending December 31, 2012 ("TY").

2. On October 24, 2013, the Commission's Utilities Division ("Staff") filed a Letter of Sufficiency indicating that Utility Source's application had met the sufficiency requirements outlined in A.A.C. R14-2-103 and classifying Utility Source as a Class C utility.

3. On October 29, 2013, a Procedural Order was issued scheduling a Procedural Conference to discuss discrepancies within the application that made it impossible to provide accurate notice of the impacts of Utility Source's proposed rates and charges for some customers. The Procedural Order also suspended the timeframe in this matter.

4. A Procedural Conference was held on November 12, 2013, and Utility Source agreed to file an amended application.

5. On January 9, 2014, Utility Source filed an amended application to address the issues raised regarding the original application.

6. On March 6, 2014, Staff filed a Letter of Sufficiency indicating that Utility Source's application, as amended, had been deemed sufficient by operation of law and that Utility Source had been classified as a Class C utility.

7. On March 14, 2014, by Procedural Order, this matter was set for hearing to commence on August 19, 2014, and other procedural requirements and deadlines were established.

8. On April 24, 2014, Utility Source filed a Notice of Customer Mailing, stating that notice

had been mailed to its customers on April 18, 2014, several days after the April 14, 2014, notice deadline established by Procedural Order.

9. On April 30, 2014, Utility Source filed a Notice of Filing Certificate of Publication, providing that the prescribed notice had been published in the *Arizona Daily Sun* on April 18, 2014.

10. On July 1, 2014, Erik A. Nielsen filed a Motion to Intervene dated June 28, 2014, several weeks after the June 6, 2014, deadline established by Procedural Order. Mr. Nielsen identified himself as a Utility Source customer.

11. On July 7, 2014, Terry Fallon filed a Motion to Intervene dated July 2, 2014. Mr. Fallon identified himself as a Utility Source customer.

12. Also on July 7, 2014, the Residential Utility Consumer Office ("RUCO") filed an Application to Intervene and Motion to Modify the Procedural Schedule.

13. On July 9, 2014, Utility Source filed a Response to RUCO's Application to Intervene, stating that the request was untimely and prejudicial and should be denied.

14. On July 10, 2014, Staff filed a Request to Modify Procedural Schedule, requesting that the deadline for Staff's direct testimony be extended by three weeks and that all other procedural dates and deadlines be adjusted accordingly.

15. Later on July 10, 2014, Staff filed a Request for a Procedural Conference or a Stay, stating that several new issues had come to light in this matter and that Staff needed time for additional discovery and to prepare direct testimony.

16. On July 11, 2014, a Procedural Order was issued scheduling a procedural conference to be held on July 15, 2014, and suspending the timeclock and procedural schedule for this matter pending a ruling on the motions.

17. On July 15, 2014, a procedural conference was held as scheduled, with Utility Source, Staff, and RUCO appearing through counsel, and Mr. Nielsen and Mr. Fallon appearing *pro se*.[2] Staff's Requests and the three intervention requests were discussed at length. Staff stated that the newly identified issues concerned a large standpipe for bulk water sales currently under construction

[2] Mr. Nielsen, Mr. Fallon, and counsel for Utility Source attended telephonically.

in Utility Source's service area, for which no discussion had been included and no *pro forma* adjustments had been made in the amended application, as well as the appropriate treatment of Well No. 4 for purposes of establishing rate base, as the need for Well No. 4 may be greater as a result of new standpipe sales. Staff requested that the deadline for its direct testimony be extended to September 4, 2014, to allow for additional discovery and analysis concerning these issues, and that the rest of the procedural schedule be adjusted accordingly. Mr. Nielsen, Mr. Fallon, and RUCO explained their interests in this matter and why their intervention requests had not been made earlier, and all three were amenable to Staff's requested extension of the procedural schedule in this matter. Only Utility Source opposed the three requests for intervention and the requested extension of the procedural schedule in this matter, asserting that the delay would be prejudicial. Utility Source did not, however, characterize the newly raised issues as irrelevant or outside the scope of this ratemaking matter. During the procedural conference, intervention was granted to Mr. Nielsen, Mr. Fallon, and RUCO. Additionally, it was determined that the deadline for Staff and Intervenors to file direct testimony would be extended to September 4, 2014, and that the remainder of the procedural schedule would be adjusted accordingly, although the August 19, 2014, hearing date would be retained to hold a public comment proceeding. In light of the newly raised issues, Utility Source requested that it be provided 30 days to prepare its rebuttal testimony and three weeks to prepare its rejoinder testimony. It was determined that a Procedural Order would be issued to establish the modified schedule for this matter.

18. On July 16, 2014, a Procedural Order was issued establishing new filing and hearing dates.

19. On August 1, 2014, Mr. Fallon filed a Petition in opposition to the Company's proposed rate increases signed by residents of Bellemont, Arizona.

20. On September 3, 2014, Mr. Nielsen filed his direct testimony.

21. On September 3, 2014, Mr. Fallon filed Exhibits A through D to his direct testimony.

22. On September 4, 2014, Staff filed the direct testimonies of John A. Cassidy, Michael Thompson, and Jorn L. Keller.

23. On September 4, 2014, RUCO filed the direct testimonies of Robert B. Mease and

Jeffrey M. Michlik.

24. On October 3, 2014, Utility Source filed the rebuttal testimonies of Thomas J. Bourassa and Lonnie McCleve.

25. On October 15, 2014, Mr. Fallon filed Exhibits E through G to his surrebuttal testimony.

26. On October 20, 2014, RUCO filed the surrebuttal testimonies of Mr. Mease and Mr. Michlik.

27. On October 20, 2014, Staff filed the surrebuttal testimony of Mr. Cassidy. Contemporaneously with that filing, Staff filed a Request for Extension of Time requesting that the deadline for filing the surrebuttal testimonies of Mr. Thompson and Mr. Keller be extended to October 21, 2014.

28. On October 20, 2014, Mr. Nielsen filed a Request for Time Extension requesting that the deadline for filing his surrebuttal testimony be extended to October 21, 2014.

29. On October 21, 2014, Staff filed the surrebuttal testimonies of Mr. Thompson and Mr. Keller.

30. On October 22, 2014, Mr. Nielsen filed his surrebuttal testimony.

31. By Procedural Order dated October 23, 2014, the extensions of time requested by Staff and Mr. Nielsen were granted.

32. On October 31, 2014, the Company filed a Motion to Reschedule Procedural Conference requesting that the prehearing conference be rescheduled for 1:00 p.m., or later, on November 13, 2014, due to a scheduling conflict.

33. On November 4, 2014, a Procedural Order was issued rescheduling the prehearing conference for November 13, 2014, at 2:30 p.m.

34. On November 7, 2014, the Company filed the rejoinder testimonies of Mr. Bourassa and Mr. McCleve.

35. On November 13, 2014, the prehearing conference was held as scheduled, with the Company, Staff, and RUCO appearing through counsel, and Mr. Nielsen and Mr. Fallon appearing

pro se.[3] At that time, RUCO requested that the hearing be continued due to a scheduling conflict with RUCO's counsel. The Company, Staff, Mr. Nielsen, and Mr. Fallon agreed to accommodate RUCO's request.

36. On November 14, 2014, a Procedural Order was issued vacating the hearing dates scheduled for November 18, 19, 20, and 21, 2014, and scheduling a procedural conference on November 18, 2014, for the purposes of discussing new hearing dates and other procedural matters.

37. On November 18, 2014, the procedural conference was held as scheduled, with the Company, Staff, and RUCO appearing through counsel, and Mr. Nielsen and Mr. Fallon appearing *pro se.*[4] Due to scheduling conflicts, Staff and RUCO proposed that the hearing be rescheduled no sooner than January of 2015. The parties agreed to meet and confer regarding potential hearing dates in January and the Company proposed to file a list of mutually agreeable hearing dates for consideration. In addition, an alternative option for regulatory treatment of the Company's standpipe operation was discussed and the parties were directed to address that alternative at the hearing.

38. On November 18, 2014, a Procedural Order was issued directing, among other things, the Company to file a list of mutually agreeable hearing dates no later than November 26, 2014.

39. On November 26, 2014, the Company filed a Notice of Dates of Availability indicating that all parties were available for hearing on February 17, 18, and 19, 2015.

40. On December 3, 2014, a Procedural Order was issued scheduling a hearing to commence on February 17, 2015 and continue, if necessary, on February 18 and 19, 2015.

41. On January 9, 2015, RUCO filed a Motion to Compel the Company to respond to RUCO's Data Request Number 2.01.

42. On January 15, 2015, RUCO filed a Notice of Withdrawal of its Motion to Compel indicating that the Company provided a response to RUCO's Data Request Number 2.01.

43. On January 16, 2015, Mr. Nielsen filed a Motion to Compel the Company to respond to his Third and Fourth Sets of Data Requests.

44. On February 4, 2015, the Company filed a Response to Mr. Nielsen's Motion to Compel

[3] Mr. Nielsen and Mr. Fallon attended telephonically.
[4] The Company, Mr. Nielsen, and Mr. Fallon attended telephonically.

stating that the motion is moot because the Company e-mailed responses to Mr. Nielsen on February 2, 2015.

45. On February 9, 2015, Mr. Nielsen filed a Response to the Company's February 4, 2015 Response stating that the Company failed to fully respond to three specific data requests and requesting a procedural conference to discuss the Motion to Compel.

46. On February 10, 2015, a Procedural Order was issued scheduling a telephonic procedural conference to address Mr. Nielsen's Motion to Compel.

47. On February 11, 2015, Staff filed a Memorandum to update its recommended regulatory treatment of the Company's standpipe operation.

48. On February 12, 2015, a telephonic procedural conference was held as scheduled, with the Company, Staff, and RUCO appearing through counsel, and Mr. Nielsen appearing *pro se*. At that time, the Company agreed to provide any documents responsive to Mr. Nielsen's data requests on February 13, 2015.[5] In addition, the parties affirmed that Staff's updated recommendation for the Company's standpipe operation would not impair the ability of any party to prepare for the hearing.

49. On February 17, 18, and 19, 2015, a full public hearing was convened as scheduled, with the Company, Staff, and RUCO appearing through counsel, and Mr. Nielsen and Mr. Fallon appearing *pro se*. At the conclusion of the hearing, the parties were directed to submit a joint schedule for filing closing briefs, reply briefs, and any final schedules.

50. On February 25, 2015, Staff filed a Briefing Schedule stating that the parties agreed to file any final schedules by March 6, 2015, closing briefs by March 24, 2015, and reply briefs by April 14, 2015.

51. On February 26, 2015, a Procedural Order was issued adopting the briefing schedule proposed by the parties.

52. On March 5, 2015, RUCO filed its final schedules.

53. On March 6, 2015, the Company and Staff filed their respective final schedules.

54. On March 11, 2015, Mr. Nielsen filed proposed expense and rate base adjustments in

[5] The Company stated that it did not have any documents responsive to two of Mr. Nielsen's outstanding data requests.

lieu of submitting final schedules. Contemporaneously with his filing, Mr. Nielsen filed a request for an extension of time to file final schedules representing that the other parties were notified of that request and there was no objection.

55. On March 24, 2015, the Company, Staff, RUCO, Mr. Nielsen, and Mr. Fallon filed their respective closing briefs.

56. On April 10, 2015, the Company filed a motion requesting that the time for filing reply briefs be extended from April 14, 2015 to April 17, 2015. Counsel for the Company represented that the other parties were notified of that request and there was no objection.

57. By Procedural Order dated April 13, 2015, the extension requests of Mr. Nielsen and the Company were granted.

58. On April 15, 2015, Mr. Fallon filed his reply brief.

59. On April 17, 2015, RUCO, Mr. Nielsen, and Staff filed their respective reply briefs.

60. On April 17, 2015, the Company filed a Motion for an Extension of Time requesting a further extension to file reply briefs from April 17, 2015 to April 20, 2015 due to a computing error.

61. On April 20, 2015, the Company filed its reply brief.

62. By Procedural Order dated April 27, 2015, the Company's request for an extension of time was granted.

63. On May 20, 2015, the Company filed a Notice of Refund of Overpayment, indicating that the Company had returned an unauthorized hook-up fee to a customer on May 6, 2015.[6]

II. BACKGROUND

64. Utility Source is an Arizona limited liability company ("LLC") that is owned by Mr. Lonnie McCleve (80 percent) and Mr. Gary Bulechek (20 percent).[7]

65. Pursuant to authority granted in Decision No. 67446 (January 4, 2005), the Company was issued a Certificate of Convenience and Necessity ("CC&N") to provide water and wastewater utility services to an area near the community of Bellemont, in Coconino County, Arizona. In that Decision, the Commission determined that the Company, which began as a homeowners' association

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[6] During the hearing, RUCO and Mr. Nielsen presented evidence that the Company invoiced an unauthorized hook-up fee from a customer on April 22, 2014. (Tr. at 251-53; Exh. RUCO-2).
[7] Tr. at 115.

controlled by the developer, installed utility facilities, provided water and wastewater services, and established rates without first having obtained authority from the Commission. As a result, the Commission imposed a penalty of $20,000 and ordered that all assets used in the provision of utility service be transferred to Utility Source. Further, the Commission denied the Company's request for authorization to collect water and wastewater hook-up fees.

66. Utility Source is a Class C utility providing water and wastewater utility service to approximately 325 customers. The Company's customers include a residential community (Flagstaff Meadows I and II, and Flagstaff Meadows Townhomes I), a hotel, a fire department station, a mobile home park, and a truck stop. The Company's current rates and charges for water and wastewater services were authorized in Decision No. 70140 (January 23, 2008).[8]

67. Staff's Consumer Services Section indicates that three customer complaints related to billing were filed with the Commission between 2011 and 2014. According to Staff, all complaints have been resolved and closed.[9]

68. The Company is currently in good standing with the Commission's Corporations Division and Staff reports that there are no delinquent compliance issues.[10]

A. <u>Water Division</u>

69. The Company's water system ("Water Division") consists of five active wells (Deep Well Nos. 1 through 4 and Shallow Well No. 2); four inactive wells (Shallow Well Nos. 1, 3, 4, and 5); two storage tanks; two 15 horsepower ("hp") booster pumps with variable frequency drives ("VFDs"); one 75 hp emergency fire booster pump; one 200 gallon pressure tank; one 120 kilowatt ("kW") emergency backup generator; a booster pump house; 34 standard fire hydrants; and a distribution system.[11] According to Staff, Deep Well No. 4 is currently operational, but is not technically needed to serve the test year customers.[12]

70. During Staff's evaluation of the amended application, Staff discovered that the Company constructed a post-test year standpipe water facility that began selling bulk water to

[8] Exh. S-1 at Exhibit MT-1.
[9] Exh. S-7 at 3.
[10] Tr. at 750-51; Exh. S-7 at 3.
[11] Exh. S-1 at Exhibit MT-1.
[12] *Id.* at 22.

commercial and individual hauling customers in September of 2014.[13] According to Staff, the production capacity of Deep Well No. 4 will be required to operate the standpipe.[14]

71. In Decision No. 70140, the Commission approved the Company's request to include Deep Well No. 4 in rate base with the expectation that the development of Flagstaff Meadows III would bring approximately 350 new customers onto the system. Due to ongoing litigation, the development of Flagstaff Meadows III has not yet commenced and the prospective customers contemplated in that Decision never materialized.[15]

72. The Company proposed in its amended application to remove costs associated with Deep Well No. 4 from rate base because it believes that well represents capacity for future customers. According to the Company, Well No. 4 is used as emergency backup to supplement water demand during extreme conditions experienced during summer months.[16] The Company, RUCO, and Staff have adjusted their respective Fair Value Rate Base ("FVRB") determinations to remove Deep Well No. 4 from rate base for the Water Division.[17]

73. According to the Arizona Department of Environmental Quality ("ADEQ") Drinking Water Compliance Status Report dated March 25, 2014, ADEQ has determined that the Company is currently delivering water that meets water quality standards required by 40 C.F.R. §§ 141, et seq. (National Primary Drinking Water Regulations) and Arizona Administrative Code ("A.A.C."), Title 18, Chapter 4.[18]

74. The Arizona Department of Water Resources ("ADWR") has reported that the Company is currently compliant with departmental requirements governing water providers and/or community water systems.[19] The Company is not located within an ADWR Active Management Area ("AMA").[20]

75. The Company has approved Curtailment and Backflow Tariffs on file with the

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[13] Staff Closing Brief ("Cl. Br.") at 6; Tr. at 31-32; 100-101.
[14] Tr. at 535.
[15] *Id.* at 46-47; 139.
[16] Exh. S-1 at 22.
[17] However, as discussed in Section IV.A., *infra*, Staff proposed including Deep Well No. 4 as part of its recommendation to isolate a separate rate base and revenue requirement for the standpipe operation.
[18] Exh. S-1 at 4-5.
[19] *Id.* at 5.
[20] *Id.*

Commission.

76. Based on Staff's engineering analysis, the Water Division has adequate production and storage capacity to serve the present customer base and reasonable growth.[21]

B. Wastewater Division

77. The Company's wastewater system ("Wastewater Division") consists of one extended aeration wastewater treatment plant ("WWTP") capable of treating approximately 100,000 gallons of wastewater per day; one inactive single batch extended aeration treatment plant ("Inactive Treatment Plant"); one facility building; one 120 kW emergency backup generator; two wastewater effluent lakes; one decorative pond; two lift stations; and a collection system. The Company stores the sludge generated from the WWTP process in two sludge holding tanks with a total storage capacity of approximately 25,500 gallons, and the Inactive Treatment Plant with a storage capacity of approximately 37,500 gallons.[22]

78. According to ADEQ Wastewater Compliance Status Report dated July 15, 2014, ADEQ has determined that the Company's WWTP is currently in compliance with ADEQ regulations.[23]

79. Based on Staff's engineering analysis, the Wastewater Division has adequate capacity to serve the current customer base and reasonable growth.[24]

III. SUMMARY OF AMENDED APPLICATION

80. For the Water Division, a summary of the parties' proposed revenue requirements and proposed revenue increases are as follows:

	Revenue Requirement	Revenue Increase	% Increase
Utility Source	$413,519	$207,335	100.56
RUCO	$267,769	$61,585	29.87
Staff	$365,926	$159,742	77.48

[21] Exh. S-1 at 4.
[22] *Id.* at Exhibit MT-1.
[23] *Id.* at 5
[24] *Id.* at 4.

For the Wastewater Division, a summary of the parties' proposed revenue requirements and proposed revenue increases are as follows:

	Revenue Requirement	Revenue Increase	% Increase
Utility Source	$318,237	$198,773	166.39
RUCO	$217,692	$98,228	82.22
Staff	$305,275	$185,811	155.54

Mr. Fallon and Mr. Nielsen did not file final schedules.[25]

81. At the conclusion of the hearing, the following issues remained in dispute among two or more of the parties: (1) the appropriate ratemaking treatment of the Company's standpipe operation; (2) various adjustments to rate base and operating income; (3) the appropriate cost of equity ("COE") and resulting rate of return ("ROR"); (4) the appropriate rate designs for the Water Division and Wastewater Division; (5) whether the Company should perform an engineering study to determine water distribution performance during high demand events; and (6) whether the Company should adopt and implement Best Management Practice Tariffs ("BMPs").

IV. RATE BASE ADJUSTMENTS

82. For the Water Division, a summary of the parties' proposed FVRB are as follows:

	FVRB
Utility Source	$1,499,779
RUCO	$1,189,760
Staff	$1,473,541[26]

83. For the Wastewater Division, a summary of the parties' proposed FVRB are as follows:

	FVRB
Utility Source	$825,880
RUCO	$354,850
Staff	$825,880

[25] In lieu of filing final schedules, Mr. Nielsen filed proposed rate base and income statement adjustments which are addressed in Sections IV and V, *infra*.

[26] The Company and Staff agree on the total FVRB for the water system facilities; however, Staff allocated 25 percent of the cost of the transmission and distribution mains as part of its recommendation to isolate a separate rate base and revenue requirement for the standpipe operation. (Exh. S-6); *see* Section IV.A., *infra*.

A. **Standpipe Operation**

84. In response to a Staff data request, the Company provided a picture of the post-test year standpipe facility which shows a two lane facility capable of delivering water simultaneously through both a four-inch pipe and a six-inch pipe.[27] Staff stated that the standpipe facility is connected to the Company's main distribution system, which effectively means that all wells will be used to support water delivery through the standpipe facility, including Deep Well No. 4.[28] According to Staff, the standpipe operation could be a significant source of additional revenues to the Company.[29]

85. Mr. McCleve testified on behalf of the Company at the hearing. According to Mr. McCleve, revenues from standpipe sales have averaged between $5,000 and $6,000 per month between September of 2014 and January of 2015.[30] Testifying further, Mr. McCleve acknowledged that water sales typically increase in the summer months of peak demand and stated that the standpipe operation will require the use of Deep Well No. 4 during peak months.[31]

86. The Company's proposed treatment of the standpipe operation is to: exclude the costs of the standpipe facilities and projected revenues from consideration in this rate case; remove the cost of Deep Well No. 4 from rate base; and increase the Company's current bulk water rate from $10.35 per 1,000 gallons to $21.75 per 1,000 gallons ("Company Standpipe Proposal").[32] To alleviate any concern that the Company might over-earn as a result of its standpipe operation, the Company stated that it would agree to file a rate case if its revenues from standpipe sales exceed the authorized revenue requirement by 10 percent or more.[33]

87. RUCO's proposed treatment of the standpipe operation is to: exclude the costs of the standpipe facilities from rate base; remove the cost of Deep Well No. 4 from rate base; increase the bulk water rate to $11.53 per thousand gallons; require Utility Source to file an annual report, by September 30th of each year, showing the revenues and expenses generated by month from the

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[27] Exh. S-7 at 23.
[28] *Id.*
[29] *Id.* at 20.
[30] Tr. at 33.
[31] *Id.* at 115-16.
[32] Company Reply Brief ("Rep. Br.") at 3-4.
[33] *Id.*

Company's standpipe operation;[34] and order Utility Source to refund any excess earnings from standpipe sales to ratepayers in the Company's next rate case ("RUCO Standpipe Proposal").[35]

88. Staff initially recommended that the Company's bulk water rate remain at $10.35 per 1,000 gallons and that the Company be required to file a rate case by June 1, 2016.[36] Staff's initial recommendation was based on the lack of data regarding the standpipe sales, revenues, investment, and operating costs.[37] According to Staff, Utility Source would not be harmed by keeping the current bulk water rate in place because recovery of the Company's annual revenue requirement is based upon billing determinants that do not include sales volumes from the standpipe facility.[38]

89. Prior to the hearing, the Administrative Law Judge ("ALJ") requested that the parties be prepared to answer questions relating to the following option for treating the standpipe operation ("ALJ Standpipe Proposal"):

> Whether it would be in the public interest to include the costs of the standpipe and related facilities in rate base and create a surcredit mechanism to return the income received from standpipe sales back to ratepayers on a monthly basis. The surcredit would be calculated as follows: the income from standpipe sales during the month, divided by the gallons (in thousands) of non-standpipe water sold in the month, would equal the credit per 1,000 gallons for the month. The surcredit rate would then be applied to the gallons billed (in thousands) to each customer. [**EXAMPLE**: Assume the Company receives $1,000 in income from standpipe sales and sells 2,000,000 gallons of non-standpipe water during the month. Under that scenario, each customer would receive a $0.50 credit per 1,000 gallons used during that month.]

90. The Company, Staff, and RUCO opposed the ALJ Standpipe Proposal. According to the Company and Staff, the ALJ Proposal is not desirable because it would be difficult to calculate the surcredit on a timely basis and unduly burdensome to administer.[39] RUCO advocated against the ALJ Proposal claiming that the inclusion of Deep Well No. 4 in rate base would ultimately be more

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[34] Mr. McCleve testified that the Company would not oppose filing an annual report showing the revenues and expenses associated with the standpipe operation because Utility Source already intends to monitor that data. (Tr. at 102-103).
[35] RUCO Cl. Br. at 12.
[36] Exh. S-7 at 23-24; Staff Cl. Br. at 6.
[37] Staff Cl. Br. at 6.
[38] Exh. S-7 at 23-24.
[39] Exh. S-6 at 2; Tr. at 224.

expensive for ratepayers.[40]

91. In response to the ALJ Standpipe Proposal, Staff revised its initial recommendation and proposed that the standpipe facility be treated as a standalone operation for ratemaking purposes with a separate revenue requirement ("Staff Standpipe Proposal").[41] Under the Staff Standpipe Proposal, the separate revenue requirement for the standpipe facility would be $127,685, which is based upon a FVRB of $506,334;[42] total operating expenses of $65,062;[43] operating income (including income taxes) of $62,623; and a rate of return of 9.80 percent.[44] Staff projected annualized sales from the standpipe operation of 6,770,592 gallons which resulted in a recommended increase of the bulk water rate from $10.35 to $18.86 per 1,000 gallons.[45] Staff further recommended that the Company file monthly standpipe sales volume reports every six months until the Company files its next rate case, which would be no later than June 30, 2019, usi ng a test year ending December 31, 2018.[46] Staff acknowledged that while the Staff Standpipe Proposal may not be a perfect solution for addressing the standpipe operation, Staff stated that it is important to address the standpipe operation in this rate case given the significant amount of revenue at stake.[47]

92. The Company opposed the Staff Standpipe Proposal arguing that any revenues, investments, or expenses associated with the standpipe operation should not be included in this rate case because the standpipe constitutes post-test year plant.[48] In addition, the Company claimed that the Staff Standpipe Proposal creates a mismatch because Staff is proposing to allocate expenses incurred in the 2012 test year to standpipe operations that began in September of 2014.[49] The Company further argued that Staff's expense allocation and projected revenues should be disregarded

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[40] RUCO Cl. Br. at 13.
[41] Exh. S-6. Mr. Nielsen joined in support of the Staff Standpipe Proposal. (Nielsen Cl. Br. at 16).
[42] Staff's recommended standpipe rate base includes the estimated cost of the standpipe facility; a 30 percent allocation of the cost of Deep Well No. 4 (less depreciation); and a 25 percent allocation of the cost of the transmission and distribution mains (less depreciation). (Staff Cl. Br. at 7; Exh. S-6).
[43] Staff's recommended standpipe expenses include, among other things, estimated purchased power and chemical costs and an allocation of a percentage of the annual operating expenses for the system. (Staff Cl. Br. at 8).
[44] Staff Cl. Br. at 7-8.
[45] Staff's estimated annualized sales volume for the standpipe facility is based on the average of the actual sales from the standpipe operation for October, November, and December of 2014. (Exh. S-6).
[46] Exh. S-6.
[47] Staff Cl. Br. at 8.
[48] Company Cl. Br. at 8.
[49] *Id.* at 9.

because they are not known and measurable.[50] According to the Company, the Staff Standpipe Proposal violates normal ratemaking procedures by splitting the Company's water operations into two separate systems.[51]

93. RUCO also opposed the Staff Standpipe Proposal on the grounds that it is "too cumbersome, involves too many assumptions and resembles a mini SIB."[52] According to RUCO, there is no guarantee that the Company will generate significant revenues from the standpipe operation.[53] Further, RUCO argued that Staff can request that the Company be ordered to file a rate case to the extent Staff believes that the Company is over-earning.[54]

Discussion and Analysis

94. We appreciate the efforts of the parties in attempting to address the effect of the standpipe operation on the Company's water system and revenues. We find that the Staff Standpipe Proposal, while novel and innovative in theory, is problematic because it matches expenses incurred by the Company in 2012 to standpipe sales beginning in late 2014. Given the lack of data regarding the standpipe sales, revenues, and operating costs, we find that it is reasonable and appropriate to keep the Company's bulk water rate at its current level and exclude the costs associated with the Company's standpipe operation until the Company's next rate case.

95. Based on the foregoing, we find that it is reasonable and appropriate to require the Company to file its next rate application no later than September 31, 2019, using a test year ending December 31, 2018. We further find that it is reasonable and appropriate to require the Company to file biannual standpipe sales volume reports, on September 31st and March 31st of each year, with the first such biannual report due no later than September 31, 2015, showing the gallons sold and revenue generated per month from the Company's standpipe operation. We direct Staff to monitor the biannual standpipe sales volume reports and make additional recommendations to the Commission, as necessary.

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[50] Company Cl. Br. at 9-10.
[51] *Id.* at 10.
[52] RUCO Cl. Br. at 13.
[53] *Id.* at 12.
[54] *Id.*

B. Contributions in Aid of Construction ("CIAC")

96. For the Water Division, Mr. Nielsen proposed that the following items be imputed as CIAC: $34,500 related to fire hydrants; $73,252 related to water distribution mains; and $201,000 related to hook-up fees. For the Wastewater Division, Mr. Nielsen proposed that the following items be imputed as CIAC: $109,206 related to wastewater distribution mains; and $361,800 related to hook-up fees.[55]

97. Mr. Nielsen argued that the fire hydrants and distribution mains should be imputed as CIAC because they were paid for with developer funds. As support, Mr. Nielsen cites: the testimony of Mr. McCleve who affirmed that Empire Development built the majority of the homes in the subdivision and paid for the underlying infrastructure;[56] and a letter from the Assistant Director of the Coconino County Community Development, stating that "[fire] hydrants, [where required,] would be considered a development cost just like roads, drainage systems, etc."[57]

98. Mr. Nielsen further argued that the proposed hook-up fee amounts should be imputed as CIAC because the Company acknowledged that it collected hook-up fees from customers prior to obtaining its CC&N.[58] As support, Mr. Nielsen cites: the testimony of Mr. McCleve who affirmed that hook-up fees were collected "before the Corporation Commission became involved;"[59] and a copy of an invoice dated April 22, 2014, collecting a hook-up fee from San Francisco Builders for Lot 30 in Flagstaff Meadows.[60]

99. The Company claimed to no longer have any documentation to substantiate the value of the utility plant and assets paid for by Utility Source. Nonetheless, the Company asserted that its proposed CIAC balance is appropriate because it is based on the CIAC balances approved in and carried-over from Decision Nos. 67447 and 70140 (the Company's previous CC&N case and rate case, respectively). According to the Company, the CIAC adjustments proposed by Mr. Nielsen

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[55] Exh. Nielsen-3 at 12-13.
[56] Tr. at 62-65.
[57] Exh. Nielsen-3 at 3.
[58] *Id.* at 13-15. The proposed reclassification of hook-up fee amounts are calculated based on the 201 customers in existence at the time the Commission granted the Company's CC&N (Decision No. 67446) multiplied by the Company's proposed water and wastewater hook-up fees in the amounts of $1,000 and $1,800, respectively.
[59] Nielsen Cl. Br. at 13; Tr. at 253.
[60] Exh. RUCO-2.

represent an impermissible collateral attack on "decisions of the commission which have become final."[61] Further, the Company argued that the adjustments proposed by Mr. Nielsen are based on speculation and conjecture and that there is no credible evidence showing that the Commission erred in approving the CIAC balances in the previous Decisions.

100. In their Closing Briefs, RUCO and Mr. Fallon joined in Mr. Nielsen's proposed adjustments to CIAC.[62] According to RUCO, the Commission is not bound in this case by its previous determinations of the Company's CIAC balance. RUCO argued that the Company failed its burden of proof because the Company failed to provide original cost documentation for the value of its plant. RUCO asserted that it is reasonable to impute CIAC where plant is known to exist and the Company fails to account for it properly.[63]

Discussion and Analysis

101. The Commission is not bound by its previous decisions in the faithful discharge of its constitutional duty to determine the fair value of a utility's plant and assets. However, we find that the proposed adjustments to impute plant and hook-up fees as CIAC are too speculative to be adopted. Even assuming the plant items identified by Mr. Nielsen were paid for with developer funds, there is no evidence documenting the amount of plant, if any, not recognized as CIAC in the previous Commission decisions. Indeed, Mr. Nielsen concedes that he estimated the amount of plant to impute as CIAC because he was unable to determine what plant was recognized as CIAC in the Company's previous rate case.[64] Similarly, there is no evidence documenting the amount of hook-up fees, if any, not recognized as CIAC in previous Decisions.[65] Although Mr. McCleve testified that hook-up fees were originally collected from customers prior to obtaining its CC&N, Mr. McCleve stated that "[c]ertainly everything was disclosed to the Commission when the original [Decision granting the CC&N] was completed."[66] Based on the foregoing, we decline to adopt the proposed adjustments to CIAC.

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[61] Company Cl. Br. at 3, *citing* A.R.S. § 40-252.
[62] RUCO Cl. Br. at 2-3; Fallon Cl. Br. at 2.
[63] RUCO Rep. Br. at 2.
[64] Nielsen Cl. Br. at 12-13.
[65] Since the Company returned the unauthorized hook-up fee to the customer, we decline to impute that amount as CIAC in this proceeding.
[66] Tr. at 254.

C. Land Values

102. The Company, Staff, and RUCO proposed land values of $210,000 and $105,000 for the Water and Wastewater Divisions, respectively.

103. Mr. Nielsen argued that the land values proposed by the Company, RUCO, and Staff are overstated. As support, Mr. Nielsen compared Coconino County property value records to extrapolate his opinion of value as to the Company's land at the time of acquisition. Mr. Nielsen proposed downward adjustments to the Company's land values in amounts of $143,105 and $74,523 for the Water and Wastewater Divisions, respectively. Mr. Nielsen argued that his estimated land values are reasonable, particularly where the Company could not substantiate the original costs of its land with supporting documentation.[67]

104. The Company claimed to no longer have any documentation to substantiate the costs of the land paid for by Utility Source. Nonetheless, the Company asserted that its proposed land values are appropriate because they were carried-over from previous Commission decisions. According to the Company, the land value adjustments proposed by Mr. Nielsen represent an impermissible collateral attack on previous Commission decisions.[68]

Discussion and Analysis

105. We note that the Commission previously determined the fair value of the Company's land in Decision Nos. 67447 and 70140. Although Mr. Nielsen offered his opinion as to the value of the Company's land at the time of acquisition, Mr. Nielsen is neither a real estate agent nor a land appraiser.[69] The Commission is not bound by its previous decisions in the faithful discharge of its constitutional duty to determine the fair value of a utility's plant and assets; however, we find that the evidence presented in this case does not support disturbing the Commission's prior determinations of the fair value of the Company's land.

D. Inactive Treatment Plant

106. The Company, Staff, and RUCO agreed that the Inactive Treatment Plant was used and useful during the test year because the Company utilizes that plant to store and dry the sludge created

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[67] Nielsen Cl. Br. at 10-11.
[68] Company Cl. Br. at 4-5.
[69] Tr. at 338.

by the WWTP. According to the Company, drying sludge before shipping it to a landfill is extremely useful and saves customers thousands of dollars in sludge hauling fees each year.[70]

107. Mr. Nielsen argued that the cost of the Inactive Treatment Plant ($333,500) should be removed from rate base because that facility has been disconnected from the system as a sewage treatment plant. Although Mr. Nielsen acknowledged that the Company uses the Inactive Treatment Plant to store sludge, he asserted that the treatment facility should be removed from rate base because it is not being used for the purpose for which it was designed.[71]

Discussion and Analysis

108. We find that the Inactive Treatment Plant was used and useful during the test year. Although the Inactive Treatment Plant is not technically being used in the manner for which it was designed, we find that the wastewater system benefits from the use of that plant as a storage facility for the sludge created by the WWTP. As a result, we decline to adopt the proposed adjustment to remove the Inactive Treatment Plant from rate base.

E. Fair Value Rate Base Summary

109. The Company did not prepare schedules showing the elements of Reconstruction Cost New Rate Base in this case. Therefore, the Company's Original Cost Rate Base shall be treated as its Fair Value Rate Base. Based on the discussion of rate base adjustments set forth above, we find the FVRB for the Water Division is $1,499,779; we further find the FVRB for the Wastewater Division is $825,880.

V. OPERATING INCOME ADJUSTMENTS

A. Shared Office Space and Office Resources

110. Mr. Nielsen proposed several adjustments to the Company's test year expenses arguing that the Company shares its office space and office resources with other business entities. At the hearing, Mr. Nielsen testified that he personally visited the Utility Source office (located in Queen Creek, Arizona) and observed outdoor signage indicating that the building was a visitor center for a development known as the Pecan's subdivision, and listing the contact information for several real

[70] Company Cl. Br. at 5.
[71] Nielsen Cl. Br. at 9-10.

estate brokers.[72] Mr. Nielsen further testified that the majority of the office interior was adorned with blueprints and promotional materials consistent with a visitor's center or sales office.[73] Testifying further, Mr. Nielsen stated that he called one of the brokers listed on the outdoor signage who confirmed that real estate brokers use the office of Utility Source to meet with customers interested in purchasing homes in the Pecan's subdivision.[74] Additionally, Mr. Nielsen stated that six other entities controlled by the owners of Utility Source share the same address as the Company's office.[75]

111. The Company argued that the office is primarily used for Utility Source business and that any shared use by any other entities is incidental. The Company stated that it allows use of its office, primarily on the weekends, as a courtesy to realtors and the Pecans Homeowners' Association, Inc. ("Pecans HOA").[76] According to the Company, the office is used by the Pecans HOA to hold meetings and by various realtors to meet with potential homebuyers in the Pecans subdivision.[77] In addition, the Company claimed that Mr. McCleve lists the address of Utility Source for his other non-affiliated businesses because he prefers to receive mail at that address, rather than his personal residence.[78]

112. Mr. McCleve testified that several entities use the Utility Source office "on occasion."[79] According to Mr. McCleve, the Pecans HOA uses the office space to hold board meetings and there are individuals who come into the office requesting information regarding home purchases in the Pecan's subdivision.[80] Mr. McCleve testified that there is no signage on the building to indicate that the office is used by Utility Source because the Company's customers do not frequent that office.[81] Testifying further, Mr. McCleve stated that while there are "regular occasions where realtors would come in [to use the office], mostly on the weekend," no realtor uses the office as their main office to

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[72] Exh. Nielsen-3 at 10.
[73] Exh. Nielsen-3 at 10.
[74] *Id.*
[75] The other non-affiliated businesses that share the same address as Utility Source include: Fuelco Travel Center, LP; Pecans of Queen Creek, LLC; The Pecan's Homeowners Association, Inc.; Strategic Funding VII, LP; Pecans 20, LLC; and Strategic GP, LLC. (Exh. Nielsen-3 at 9).
[76] Company Rep. Br. at 6.
[77] *Id.*
[78] *Id.*
[79] Tr. at 38.
[80] *Id.*
[81] *Id.* at 71; 96.

sell homes.[82]

113. Ms. Mary Ann Parry provides professional bookkeeping, billing, and customer contact services for the Water and Wastewater Divisions. The Company argued that the majority of Ms. Parry's time is spent on Utility Source business. According to the Company, Ms. Parry performs all of the office work for both the Water and Wastewater Divisions, and that her work for the Pecans HOA is incidental.[83] The Company further argued that employing a fulltime bookkeeper is necessary given the size of Utility Source.

114. Mr. McCleve testified that Ms. Parry provides general information and referrals to prospective homebuyers, but the "vast majority of [Ms. Parry's] time is spent with Utility Source."[84] Mr. McCleve further explained that Ms. Parry does "some work" for the Pecans HOA, but "not to any great extent." Mr. McCleve testified that Ms. Parry's Utility Source phone number is listed on the outdoor signage for the Pecan's subdivision.[85]

Discussion and Analysis

115. We find that the business activities of the other entities sharing the office space and office resources of Utility Source are more than incidental. The evidence shows that the Pecans HOA conducts most, if not all, of their official business at the office of Utility Source; Utility Source liberally allows the use of its office for realtors and prospective homebuyers in the Pecans subdivision; the office is setup to cater to the Pecans subdivision and real estate community; and there is no signage or markings otherwise indicating that the office is utilized by Utility Source. Although the Company characterizes the shared use of its office as a courtesy, we do not believe ratepayers should bear the cost of that courtesy.

116. Further, it is apparent that Ms. Parry's time spent with the other entities and individuals sharing the office space of Utility Source is more than incidental. Ms. Parry provides information and referrals to prospective homebuyers and is listed as the point of contact for the Pecans HOA.[86] Moreover, Ms. Parry is secretary for the Pecans HOA and has duties and responsibilities in that

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[82] Tr. at 97-98.
[83] Company Cl. Br. at 7.
[84] Tr. at 74.
[85] *Id.* at 72.
[86] *Id.* at 74; Exh. Nielsen 5-7.

capacity.[87] The Company did not submit timesheets or other evidence to rebut the evidence of Ms. Parry's shared duties and obligations with the other entities and individuals sharing the Utility Source office space.

117. Based on the record, we find that it is reasonable and appropriate to allocate 20 percent of the Company's test year expenses relating to the office and office resources to the other entities and individuals sharing the Company's office space.

B. <u>Rent Expense</u>

118. The Company's office building is owned by Mr. McCleve and measures approximately 900 feet.[88] During the test year, the Company paid the Salt River Project ("SRP") electricity bill for Mr. McCleve's personal residence in lieu of paying rent to Mr. McCleve.[89] According to Staff, the Company paid a total of $9,498 in SRP bills for Mr. McCleve's personal residence during the test year.[90]

119. To determine a reasonable rent expense for the Company, Staff consulted the United States General Services Administration's references for adequate square footage and calculated that a utility the size of Utility Source would require an office size of approximately 1,000 square feet.[91] Staff surveyed ads for office space in Queen Creek and determined that $16 per square foot would be an appropriate amount. Based on Staff's analysis, it would be reasonable for the Company to pay $16,000 per year to rent adequate office space in Queen Creek. Staff therefore concluded that the Company's proposed total rent expense of $9,498 was a reasonable amount for both the Water and Wastewater Divisions.[92]

120. Staff adjusted the Company's miscellaneous expense to remove $9,498 from the Water and Wastewater Divisions[93] and reclassified that amount as rent expense, apportioned between the

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[87] Tr. at 78; Company Cl. Br. at 7.
[88] Tr. at 72; 78; 116-17.
[89] *Id.* at 117-18.
[90] Exh. S-6 at JLK-W8 and JLK-WW8. Mr. Nielsen and RUCO claimed that the Company paid a total of $12,040 in SRP bills for Mr. McCleve's personal residence. (Exh. Nielsen-3 at 14; RUCO Cl. Br. at 3-4).
[91] Tr. 749-50.
[92] Exh. S-6 at JLK-W8 and JLK-WW8.
[93] Staff removed from test year miscellaneous expense the amounts of $2,353 and $7,145 for the Water and Wastewater Divisions, respectively, for a total of $9,498. (Exh. S-6 at JLK-W8 and JLK-WW8).

Water and Wastewater Division in the amounts of $6,014 and $3,484, respectively.[94] The Company accepted Staff's adjustment.

121. Mr. Nielsen and RUCO agreed that Mr. McCleve's personal SRP bills should be removed from the Company's test year miscellaneous expense, but made no corresponding adjustment to recognize rent expense for the Company. Mr. Nielsen argued that Staff's reclassified rent expense should not be included as part of the revenue requirement because the Company did not record a rent or lease expense during the test year.[95] In the alternative, Mr. Nielsen asserted that any allowable rent expense should be reduced because of the other entities sharing the Company's office space.[96]

Discussion and Analysis

122. We find that it is clearly inappropriate for the Company to pay the SRP bill for Mr. McCleve's personal residence in lieu of paying rent. We therefore order the Company to discontinue this arrangement going forward.[97] Although the Company's rent expense arrangement is not appropriate, we note that to disallow rent expense entirely would unfairly penalize the Company.

123. Based on Staff's analysis, a reasonable rent expense for the Company would be approximately $16,000 for the Water and Wastewater Divisions. As discussed above, we find that it is reasonable and appropriate to allocate 20 percent of the office rent expense to the other entities and individuals sharing the office space of Utility Source. Thus, we adopt an adjusted test year rent expense of $12,800, apportioned evenly between the Water and Wastewater Divisions.

C. Contractual Services – Accounting Expense

124. The Company proposed test year accounting expense of $20,253 and $20,135 for the Water and Wastewater Divisions, respectively. The proposed test year accounting expense covers the annual salary of Ms. Parry who provides professional bookkeeping, billing, and customer contact services for Utility Source. Staff made no adjustment to the Company's test year accounting expense.

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[94] Exh. S-6 at JLK-W8 and JLK-WW8.
[95] Nielsen Cl. Br. at 7.
[96] *Id.*
[97] Mr. McCleve testified that the Company agrees to discontinue this arrangement going forward. (Tr. 39-40).

125. Mr. Nielsen proposed adjusting test year accounting expense downward by $16,250, apportioned evenly between the Water and Wastewater Divisions. According to Mr. Nielsen, Ms. Parry's annual salary should be reduced because: (1) her salary is excessive for the work required to provide bookkeeping services to Utility Source; and (2) she comingles her time working for other entities controlled by the owners of Utility Source.[98]

Discussion and Analysis

126. As discussed above, we find that it is reasonable and appropriate to allocate 20 percent of the test year accounting expense to the other entities and individuals sharing the office space of Utility Source. Thus, we adopt adjusted test year contractual services - accounting expenses of $16,202 and $16,108 for the Water and Wastewater Divisions, respectively.

D. Miscellaneous Expense

1. Telephone Expense

127. In its amended application, the Company proposed a test year telephone expense of $9,464, apportioned evenly between the Water and Wastewater Divisions. Staff determined that the telephone expense proposed in the amended application was excessive and recommended an adjusted telephone expense of $4,732, apportioned evenly between the Water and Wastewater Divisions.[99] The Company accepted Staff's adjustment to telephone expense.[100]

128. At the hearing, Mr. McCleve testified that Utility Source maintains two cell phone plans and two landlines, one local number and one toll-free number, for customers to call if they have service or billing issues with the Company.[101] Mr. McCleve further testified that Ms. Parry and himself are primary users on the two cell phone plans, and that his wife and daughter are secondary users on both plans.[102] Mr. McCleve explained that he considered the cell phone expense of his wife and daughter as part of his direct compensation from the Company.[103] Mr. McCleve recognized that having Utility Source pay the personal cell phone bills of his wife and daughter in lieu of direct

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[98] Nielsen Cl. Br. at 4-5.
[99] Exh. S-7 at 13.
[100] Exh. A-5 at 12.
[101] Tr. at 76.
[102] *Id.* at 75.
[103] *Id.*

compensation from the Company "was probably not the best way of doing it" and indicated that this arrangement would not continue in the future.[104]

129. Mr. Nielsen proposed a telephone expense of $2,298.22, apportioned evenly between the Water and Wastewater Divisions.[105] According to Mr. Nielsen, the Company's comingling of business activities and the inclusion of Mr. McCleve's wife and daughter on the Company's cell phone plan support his proposed reduction to telephone expense.[106]

Discussion and Analysis

130. We find that it is clearly inappropriate for the Company to pay the personal cell phone bills of Mr. McCleve's wife and daughter. We therefore order the Company to discontinue this arrangement going forward.[107]

131. Staff's adjustment to telephone expense did not incorporate an allocation for shared office resources. As discussed above, we find that it is just and reasonable to allocate 20 percent of the test year telephone expense to the other entities and individuals sharing the office space of Utility Source. Thus, we adopt an adjusted test year telephone expense of $3,786, apportioned evenly between the Water and Wastewater Divisions.

2. Copy Machine / Office Supply Expenses

132. The Company proposed total test year office supply expense of $1,192 and copier expense of $4,521, both expenses apportioned evenly between the Water and Wastewater Divisions. Staff accepted the Company's test year copier expense and office supply expense.

133. Mr. Nielsen argued that expenses associated with the copier and office supplies should be shared proportionally between the other entities sharing the office of Utility Source. According to Mr. Nielsen, it is reasonable under the circumstances to presume that these entities require billing, invoicing, or other activities that utilize copier and office supplies.[108] Mr. Nielsen proposed adjusting

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[104] Tr. at 75-76.
[105] In its Closing Brief, RUCO joined in Mr. Nielsen's telephone expense adjustment arguing that the Company failed to segregate its costs among the other entities sharing office space with Utility Source. (RUCO Cl. Br. at 5).
[106] Nielsen Cl. Br. at 5.
[107] Mr. McCleve testified that the Company agrees to discontinue this arrangement going forward. (Tr. 75).
[108] Nielsen Cl. Br. at 6.

the copier expense from $4,521 to $678, and the office supply expense from $1,192 to $596.[109] Mr. Nielsen asserted that his adjustments are reasonable because they more accurately reflect the true costs incurred by Utility Source.[110]

Discussion and Analysis

134. As discussed above, we find that it reasonable and appropriate to allocate 20 percent of the test year copy machine and office supply expenses to the other entities and individuals sharing the office space of Utility Source. Thus, we adopt an adjusted test year copy machine expense of $3,617, apportioned evenly between the Water and Wastewater Divisions, and adopt an adjusted test year office supply expense of $954, apportioned evenly between the Water and Wastewater Divisions.

3. Automobile Expense

135. In its amended application, the Company proposed a total automobile expense of $6,500, split evenly between the Water and Wastewater Divisions. According to the Company, the automobile expense is reimbursement to Ms. Parry for using her personal automobile to run errands for Utility Source, which includes trips to ADEQ and the Commission, as well as traveling to Bellemont once every few months for Utility Source business.[111]

136. Staff determined the automobile expense proposed in the amended application to be excessive.[112] Using the Internal Revenue Service's approved rate of $0.555 per mile for business automobile expense in 2012 ("IRS rate"), Staff calculated that Ms. Parry would need to drive 11,700 miles during the test year to justify an automobile expense of $6,500.[113] Staff recommended a test year automobile expense of $3,000, apportioned evenly between the Water and Wastewater Divisions.[114] According to Staff, its recommended automobile expense is reasonable because it provides mileage reimbursement for six annual round trips to Bellemont, plus an additional 3,600 business miles per year.[115] The Company accepted Staff's adjustment to automobile expense.[116]

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[109] Exh. Nielsen-3 at 13-14. RUCO joined in Mr. Nielsen's adjustments arguing that the Company failed its burden of segregating costs for its many businesses. (RUCO Cl. Br. at 4-5).
[110] Exh. Nielsen-3 at 14.
[111] Tr. at 79.
[112] Exh. S-7 at 12-13.
[113] *Id.*
[114] *Id.*
[115] *Id.*
[116] Exh. A-5 at 12.

137. Mr. Nielsen argued that the automobile expense should be further reduced because it is unreasonable for ratepayers to pay for Ms. Parry to travel to Bellemont, which is over 150 miles away from the Company's office in Queen Creek.[117] According to Mr. Nielsen, a more reasonable automobile expense should only allow the costs of two round trips for errands per week, for a total of 40 miles.[118] Utilizing the IRS rate employed by Staff, Mr. Nielsen proposed a total automobile expense of $1,084.80, apportioned evenly between the Water and Wastewater Divisions.[119]

138. The Company argued that its adjusted automobile expense is reasonable because Ms. Parry performs all of the Company errands, including banking and traveling to purchase office supplies.[120] Additionally, the Company argued that providing an automobile allowance to Ms. Parry for the use of her personal vehicle for Company business is less expensive than the Company purchasing, insuring, and maintaining its own vehicle.[121]

Discussion and Analysis

139. The evidence shows that Ms. Parry's duties with Utility Source require her to travel on occasion. We find that Staff's recommended automobile expense is reasonable and appropriate under the circumstances. Thus, we adopt Staff's recommended test year automobile expense of $3,000, apportioned evenly between the Water and Wastewater Divisions, as accepted by the Company.

E. Rate Case Expense

140. The Company, Staff, and RUCO recommended $100,000 in rate case expense, apportioned evenly between the Water and Wastewater Divisions.[122] The Company, Staff, and RUCO agreed that rate case expense should be amortized over the number of years in which the Company is required to file its next rate case.[123]

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[117] Nielsen Cl. Br. at 6. RUCO joined in Mr. Nielsen's adjustment to automobile expense. (RUCO Cl. Br. at 5).
[118] Nielsen Cl. Br. at 6.
[119] Exh. Nielsen-3 at 13-14. In its Closing Brief, RUCO joined in Mr. Nielsen's adjustment arguing that the Company failed to segregate its costs among the other entities sharing office space with Utility Source. (RUCO Cl. Br. at 5).
[120] Company Rep. Br. at 7.
[121] *Id.*
[122] Tr. at 159-160; RUCO Cl. Br. at 6-7; Staff Cl. Br. at 11-12. Mr. Nielsen and Mr. Fallon did not present evidence regarding rate case expense.
[123] Staff Cl. Br. at 11. RUCO Cl. Br. at 6. Although RUCO preferred that rate case expense be recovered through a surcharge mechanism, RUCO stated that it did not object to amortizing rate case expense over the number years in which the Company is required to file its next rate case. (RUCO Cl. Br. at 6).

Discussion and Analysis

141. We find that the rate case expense, as recommended by the Company, Staff, and RUCO, is reasonable and appropriate. As discussed above, the Company is required to file its next rate case by September 31, 2019. Thus, we find that it is reasonable and appropriate to amortize rate case expense over a period of five years and adopt a rate case expense of $20,000, apportioned evenly between the Water and Wastewater Divisions.

F. Purchased Power Expense

1. Deep Well No. 4 Power Expense

142. Mr. Nielsen proposed to adjust the Company's purchased power expense to remove $4,950 in costs associated with the operation of pumps and facilities for Deep Well No. 4. Mr. Nielsen argued that the purchased power expense associated with Deep Well No. 4 should be disallowed entirely because the Company elected to remove Deep Well No. 4 from rate base.[124]

143. The Company argued that the proposed power expense for Deep Well No. 4 should be allowed because the Company relies on Deep Well No. 4 for emergency backup capacity.[125]

144. We find that the Company's proposed recovery of the power expense associated with Deep Well No. 4 creates a mismatch with its election to remove Deep Well No. 4 from rate base. Since the Company has elected to remove Deep Well No. 4 from rate base, we find that the corresponding costs of $4,950 should be removed from the Company's purchased power expense.

2. APS Late Fees

145. In its amended application, the Company proposed to include the late fees associated with untimely payments of electric bills to Arizona Public Service Company ("APS") as part of its test year purchased power expenses. Mr. Nielsen, RUCO, and Staff argued that the APS late fees should be removed from the Company's purchased power expense.

146. Staff determined that the total amount paid to APS in late fees for the Water and Wastewater Divisions during the test year was $733 and recommended a corresponding adjustment to

[124] Exh. Nielsen-3 at 13-14. In its Closing Brief, RUCO joined in Mr. Nielsen's purchased power expense adjustment arguing that Deep Well No. 4 is not used and useful. (RUCO Cl. Br. at 3).
[125] Company Rep. Br. at 8.

purchased power expense.[126] The Company accepted Staff's adjustment to remove APS late fees.[127]

147. We find that late fees caused by untimely bill payments should be an expense attributed to the utility owner/shareholder and not the ratepayer. Thus, we adopt the adjustment for APS late fees, as recommended by Staff and accepted by the Company.

G. Property Tax Expense

148. In calculating property tax expense, the Company utilized a property tax assessment ratio of 20.00 percent; RUCO utilized a property tax assessment ratio of 18.125; and Staff utilized a property tax assessment ratio of 19.00.

149. We find that utilizing a property tax assessment ratio of 18.5 percent is reasonable in this case because that is the assessment ratio that will be in effect at the time rates become effective.

H. Income Tax Expense

150. RUCO argued that the Company should not be allowed to recover income tax expense because Utility Source does not report income taxes at the corporate level.

151. Consistent with Commission policy, we find that it is reasonable and appropriate to allow the recovery of income tax expense in an amount consistent with the revenue requirement authorized herein.

I. Operating Income Summary

152. Based on the discussion of operating income adjustments set forth above, we find the adjusted test year operating income for the Water Division to be as follows:

Revenues	Operating Expenses	Operating Income (Loss)
$206,184	$199,264	$6,920

153. Based on the discussion of operating income issues set forth above, we find the adjusted test year operating income for the Wastewater Division to be as follows:

Revenues	Operating Expenses	Operating Income (Loss)
$119,464	$196,774	$(77,310)

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[126] Specifically, Staff removed $526 from the Water Division and $207 from the Wastewater Division. (Exh. S-6 at JLK-W8 and JLK-WW8). Mr. Nielsen and RUCO proposed an adjustment to remove a combined $824 in APS late fees for the Water and Wastewater Divisions. (Exh. Nielsen-2 at 15; RUCO Cl. Br. at 4).

[127] Company Final Schedules ("Final Sch.") at Exh. C-1

VI. COST OF CAPITAL

154. Utility Source, RUCO, and Staff agree that the Company's capital structure consists of 100 percent equity and 0.0 percent debt. Since the Company has no debt, its cost of equity ("COE") is the same as its weighted average cost of capital ("WACC"). Utility Source proposed a COE of 11.00 percent; RUCO proposed a COE of 9.25 percent; and Staff recommended a COE of 9.80 percent.[128]

A. Utility Source

155. Because Utility Source is not publicly traded, there is no market data specific to the Company. As a result, the Company's cost of capital witness, Mr. Thomas Bourassa, used the constant-growth Discounted Cash Flow ("DCF") model, Capital Asset Pricing model ("CAPM"), and Build-up Risk Premium method ("Build-Up Method") to estimate a cost of equity for the Company based on a proxy group of water utilities selected from the *Value Line Investment Survey*. The range of Mr. Bourassa's DCF, CAPM, and Build-up Method analyses indicated a COE in the range of 9.00 percent to 11.60 percent with a midpoint of 10.30 percent, which he then adjusted upward by 70 basis points to account for the Company's smaller size and greater risk compared to the proxy group ("Small Firm Risk Adjustment").[129] The result of Mr. Bourassa's adjustment was a COE recommendation of 11.00 percent.

156. The Company argued that its COE recommendation is conservative given the significant business and investment risk facing small utilities like Utility Source. The Company maintained that the "Small Firm Risk Adjustment" is warranted because small utilities face more risk than larger utilities. The Company argued that the COE analyses of Staff and RUCO are flawed because they purport to treat small utilities like large utilities. According to the Company, small utilities cannot sell bonds, do not have access to publicly traded equity markets, and are typically unable to obtain loans from banks in Arizona. As a result, the Company asserted that small utilities like Utility Source face extreme difficulties raising capital, which in turn increases risk.[130] The Company further argued

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[128] Mr. Nielsen advocated for the lower range of the cost of capital estimates presented by the other parties. (Ex Nielsen-3 at 7-8). Mr. Fallon did not present evidence or testimony on cost of capital.
[129] Ex A-6 at 2; Tr. at 156-57.
[130] Company Cl. Br. at 13-14.

that the upward adjustments made by Staff and RUCO were arbitrary adjustments to mask the unreasonably low results derived from their respective cost of capital model results.[131]

B. RUCO

157. RUCO used the weighted average of its constant-growth DCF model (8.71 percent), CAPM model (7.25 percent), and Comparable Earnings analysis (9.75 percent) to arrive at a COE of 8.55 percent. RUCO asserted that an additional upward 70 basis point adjustment is necessary to recognize the higher results of the Comparable Earnings analysis relative to the CAPM model ("Comparable Earnings Adjustment"), resulting in an overall COE recommendation of 9.25 percent.[132]

158. RUCO argued that Staff's "Economic Assessment Adjustment" should be rejected because it is not supported by any mathematical computation or analysis. RUCO stated that if the 60 basis point "Economic Assessment Adjustment" is removed from Staff's analysis, the resulting COE figure (9.20 percent) would be comparable to RUCO's proposed COE of 9.25 percent.[133]

159. RUCO likewise argued that the Company's "Small Firm Risk Adjustment" should be rejected because it is speculative and relies too heavily on future projections. Additionally, RUCO argued that the Company has less risk than the utilities in the proxy group because the Company carries no debt. RUCO asserted that its COE recommendation is the only reasonable option given the Company's inflated cost of capital model results and Staff's unsupported "Economic Assessment Adjustment."[134]

C. Staff

160. Staff utilized both a constant-growth DCF model and a multi-stage DCF model in calculating its recommended COE. For the constant growth DCF model, Staff's results were 8.80 percent, while the results for the multi-stage model were 9.50 percent. Staff's overall DCF estimate is 9.20 percent. Staff asserted that an additional upward 60 basis point "Economic Assessment Adjustment" is also necessary to account for the present uncertainty of the economic environment,

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[131] Company Cl. Br. at 13-14.
[132] Tr. at 508-509.
[133] RUCO Cl. Br. at 11-12.
[134] RUCO Cl. Br. at 11-12; RUCO Rep. Br. at 4.

resulting in an overall COE recommendation of 9.80 percent.[135]

161. Staff argued that the Company's COE recommendation of 11.00 percent is not reflective of current market conditions because Utility Source utilized inputs in its cost of capital models that overstated the Company's COE. Additionally, Staff argues that the Commission should reject the Company's "Small Firm Risk Adjustment" because: 1) the Company has no exposure to financial risk because the Company does not utilize debt financing; and 2) the Commission has consistently rejected such an adjustment in the past. According to Staff, the "Small Firm Risk Adjustment" is unwarranted absent exposure to financial risk.[136]

162. Staff noted that all parties offering cost of capital testimony utilized adjustments in reaching their respective COE recommendations. Staff indicated that its "Economic Assessment Adjustment" is based on the same professional judgment employed by the other parties in presenting their respective cost of capital adjustments.[137]

D. <u>Discussion and Analysis</u>

163. In the *Bluefield* and *Hope* decisions, the United States Supreme Court established a "comparable earnings" standard to determine if state regulators are adopting a reasonable return for utility companies. In *Bluefield*, the Court held that:

> 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 county 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.[138]

The Court found 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

[135] Staff Cl. Br. at 3-5.
[136] *Id.*
[137] Staff Rep. Br. at 1-2.
[138] *Bluefield*, 262 U.S. at 692-93.

confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment."[139]

In *Hope*, the Court found that:

> [T]he return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[140]

164. The parties presenting evidence on COE utilized the same methodology of using a proxy group of publicly traded utilities and cost of capital models to estimate the COE for Utility Source. The parties presented evidence for COE that ranged from 7.24 percent to 11.60 percent, before making adjustments based on risk, small firm size, low CAPM model results, and/or economic conditions. After making the adjustments, the parties' recommended COE ranged from 9.25 percent to 11.00 percent.

165. The *Bluefield* and *Hope* decisions provide that the Commission must determine a return that is equivalent to an investment with similar risk made at generally the same time, and should be sufficient under efficient management to enable the utility to discharge its duties. The Court in *Bluefield* also held, "[w]hat annual rate will constitute just compensation depends on many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts."[141] Based on all of the evidence presented, including the impact on ratepayers, we find that a COE of 9.80 percent is appropriate, will provide the Company with a reasonable return on its investment, and will result in just and reasonable rates.[142] We note that the COE adopted herein is within the range of each party's respective COE analysis.

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[139] *Id.* at 690.
[140] *Hope*, 320 U.S. at 603.
[141] *Bluefield*, 262 U.S. at 692.
[142] We note that our COE finding does not adopt: the 70 basis point "Small Firm Risk Adjustment" proposed by the Company; the 70 basis point "Comparable Earnings Adjustment" proposed by RUCO; or the 60 basis point "Economic Assessment Adjustment" proposed by Staff.

E. Cost of Capital Summary

166. Based on the discussion above, the cost of capital for the Water and Wastewater Divisions is determined to be:

	Percentage	Cost	Weighted Avg. Cost
Common Equity	100.00%	9.80%	9.80%
Debt	0.00%	0.00%	0.00%
Weighted Avg. Cost of Cap.			9.80%

VII. REVENUE REQUIREMENT

A. Water Division

167. Based on our findings herein, we determine the gross revenue for Utility Source's Water Division should increase by $177,604, or 86.14 percent, from $206,184 in the test year, to $383,788.

Fair Value Rate Base	$1,499,779
Adjusted Test Year Operating Income (Loss)	$6,919
Required Fair Value Rate of Return	9.80%
Required Operating Income	$146,978
Operating Income Deficiency	$140,059
Gross Revenue Conversion Factor	1.26806
Gross Revenue Increase	$177,604
Adjusted Test Year Revenue	$206,184
Authorized Revenue Requirement	$383,788
Revenue Increase	86.14%

B. Wastewater Division

168. Based on our findings herein, we determine that gross revenue for Utility Source's Wastewater Division should increase by $190,043, or 159.08 percent, from $119,464 in the test year to $309,507.

Fair Value Rate Base	$825,880
Adjusted Test Year Operating Income (Loss)	$(77,310)
Required Fair Value Rate of Return	9.80%

Required Operating Income	$80,936
Operating Income Deficiency	$158,246
Gross Revenue Conversion Factor	1.20093
Gross Revenue Increase	$190,043
Adjusted Test Year Revenue	$119,464
Authorized Revenue Requirement	$309,507
Revenue Increase	159.08%

VIII. RATE DESIGN

A. Water Division

169. The Company, RUCO, and Staff proposed multi-tier inverted block commodity rate structures with differences in the monthly minimum and commodity charges as well as break-over points in the commodity charges. The proposed rates and charges of the parties, based on their respective revenue requirements, are as follows:

	Current Rates	Company	Proposed Rates RUCO	Staff
MONTHLY USAGE CHARGE: (All Classes)				
5/8" x ¾" Meter	$18.50	$39.22	$23.00	$23.40
¾" Meter	18.50	39.22	23.00	35.10
1" Meter	46.50	98.05	57.50	75.00
1 ½" Meter	92.50	196.10	115.00	150.00
2" Meter	148.00	313.76	184.00	240.00
3" Meter	296.00	627.52	368.00	480.00
4" Meter	462.50	980.50	575.00	750.00
6" Meter	925.00	1,961.00	1,150.00	1,500.00
COMMODITY CHARGES: (per 1,000 gallons)				
5/8" x ¾" Meter – Residential				
0 to 4,000 gallons	$4.80	$7.55	$6.47	N/A
4,001 to 9,000 gallons	7.16	15.05	9.63	N/A
Over 9,000 gallons	8.60	21.05	11.53	N/A

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0 to 3,000 gallons	N/A	N/A	N/A	$5.60
3,001 gallons to 10,000	N/A	N/A	N/A	10.95
Over 10,000 gallons	N/A	N/A	N/A	20.33
5/8" x ¾" Meter - Commercial				
0 to 4,000 gallons	$4.80	$7.55	N/A	N/A
4,001 to 9,000 gallons	7.16	15.05	N/A	N/A
Over 9,000 gallons	8.60	21.05	N/A	N/A
First 9,000 gallons	N/A	N/A	$9.63	N/A
Over 9,000 gallons	N/A	N/A	11.53	N/A
First 10,000 gallons	N/A	N/A	N/A	$10.95
Over 10,000 gallons	N/A	N/A	N/A	$20.33
¾" Meter - Residential				
0 to 4,000 gallons	$4.80	$7.55	$6.47	N/A
4,001 to 9,000 gallons	7.16	15.05	9.63	N/A
Over 9,000 gallons	8.60	21.05	11.53	N/A
0 to 3,000 gallons	N/A	N/A	N/A	$5.60
3,001 gallons to 10,000	N/A	N/A	N/A	10.95
Over 10,000 gallons	N/A	N/A	N/A	20.33
¾" Meter - Commercial				
0 to 4,000 gallons	$4.80	$7.55	N/A	N/A
4,001 to 9,000 gallons	7.16	15.05	N/A	N/A
Over 9,000 gallons	8.60	21.05	N/A	N/A
First 9,000 gallons	N/A	N/A	$9.63	N/A
Over 9,000 gallons	N/A	N/A	11.53	N/A
First 10,000 gallons	N/A	N/A	N/A	$10.95
Over 10,000 gallons	N/A	N/A	N/A	$20.33
1" Meter – All Classes				
First 27,000 gallons	$4.80	$15.05	N/A	N/A
Over 27,000 gallons	7.16	21.05	N/A	N/A
First 18,000 gallons	N/A	N/A	$9.63	N/A
Over 18,000 gallons	N/A	N/A	11.53	N/A
First 11,000 gallons	N/A	N/A	N/A	$10.95
Over 11,000 gallons	N/A	N/A	N/A	20.33
1 ½" Meter – All Classes				
First 57,000 gallons	$4.80	$15.05	N/A	N/A
Over 57,000 gallons	7.16	21.05	N/A	N/A

First 33,000 gallons	N/A	N/A	$9.63	N/A
Over 33,000 gallons	N/A	N/A	11.53	N/A
First 13,000 gallons	N/A	N/A	N/A	$10.95
Over 13,000 gallons	N/A	N/A	N/A	20.33
2" Meter – All Classes				
First 94,000 gallons	$4.80	$15.05	N/A	N/A
Over 94,000 gallons	7.16	21.05	N/A	N/A
First 52,000 gallons	N/A	N/A	$9.63	N/A
Over 52,000 gallons	N/A	N/A	11.53	N/A
First 16,000 gallons	N/A	N/A	N/A	$10.95
Over 16,000 gallons	N/A	N/A	N/A	20.33
3" Meter – All Classes				
First 195,000 gallons	$4.80	$15.05	N/A	N/A
Over 195,000 gallons	7.16	21.05	N/A	N/A
First 104,000 gallons	N/A	N/A	$9.63	N/A
Over 104,000 gallons	N/A	N/A	11.53	N/A
First 26,000 gallons	N/A	N/A	N/A	$10.95
Over 26,000 gallons	N/A	N/A	N/A	20.33
4" Meter – All Classes				
First 309,000 gallons	$4.80	$15.05	N/A	N/A
Over 309,000 gallons	7.16	21.05	N/A	N/A
First 160,000 gallons	N/A	N/A	$9.63	N/A
Over 160,000 gallons	N/A	N/A	11.53	N/A
First 37,000 gallons	N/A	N/A	N/A	$10.95
Over 37,000 gallons	N/A	N/A	N/A	20.33
6" Meter – All Classes				
First 615,000 gallons	$4.80	$15.05	N/A	N/A
Over 615,000 gallons	7.16	21.05	N/A	N/A
First 325,000 gallons	N/A	N/A	$9.63	N/A
Over 325,000 gallons	N/A	N/A	11.53	N/A
First 71,000 gallons	N/A	N/A	N/A	$10.95
Over 71,000 gallons	N/A	N/A	N/A	20.33
Irrigation Meters (all usage)	$9.26	$15.05	$11.53	$20.33

Standpipe or Bulk (all usage)	$10.35	$21.05	$11.53	$18.86
Construction (all usage)	$10.35	$21.05	$11.53	$18.86

170. The Company argued that its proposed water rate design should be adopted because it offers revenue stability while promoting water conservation efforts.[143] RUCO asserted that its water rate design will allow customer the best opportunity to conserve while still providing revenue stability for the Company.[144] Staff argued that its rate design strikes an appropriate balance between the Company's need for revenue stability and water conservation efforts.[145]

171. The Company's proposed changes to its rate design would increase the typical residential 3/4-inch bill with a median usage of 3,500 gallons from $35.30 to $65.65, an increase of $30.35, or 85.97 percent. Staff's recommended rate design would increase the typical 3/4-inch meter residential bill with a median usage of 3,500 gallons from $35.30 to $57.38, an increase of $22.08, or 62.54 percent. RUCO's recommended rate design would increase the typical 3/4-inch meter residential bill with a median usage of 3,500 gallons from $35.30 to $45.65, an increase of $10.35, or 29.31 percent.

Discussion and Analysis

172. The rate designs proposed by the Company and Staff represent a significant modification from the existing rate design and the impact on customer bills would vary widely from the percentage increase in the revenue requirement. For example, the Company proposes an overall revenue increase of 100.56 percent; however, a typical 3/4-inch meter customer with median usage would experience a bill increase of 85.97 percent while customers using either less than 2,000 gallons per month or more than 10,000 gallons per month would experience increases exceeding the overall proposed percentage increase in revenue. Staff proposes an overall revenue increase of 77.48 percent; however, a typical 3/4-inch meter customer with median usage would experience a bill increase of 62.54 percent while any customer with usage exceeding 14,000 gallons per month would experience a bill increase exceeding the overall proposed percentage increase in revenue. We believe

[143] Company Cl. Br. at 12.
[144] RUCO Cl. Br. at 9.
[145] Staff Cl. Br. at 10.

that the rate designs proposed by the Company and Staff are not desirable because they exacerbate the percentage increase in some customer bills. In recognition of the relatively high overall increase in revenue adopted herein, we find it reasonable and appropriate to adopt a rate design that largely follows the existing rate structure, adjusted to recover the revenue requirement authorized herein, with the following modifications: 1) the break-over points between the first and second tier commodity rates are reduced for each meter size; and 2) the minimum monthly usage charges for the 3/4-inch and 1-inch meters are reduced to multiples of 1.1 and 1.5, respectively, of the 3/4-inch meter minimum monthly usage charge. Based on the foregoing, we find the following rates for the Water Division to be just and reasonable:

	Rates
MONTHLY USAGE CHARGE:	
(All Classes)	
5/8" x ¾" Meter	$32.68
¾" Meter	35.95
1" Meter	49.02
1 ½" Meter	163.40
2" Meter	261.44
3" Meter	522.88
4" Meter	817.00
6" Meter	1,634.00
COMMODITY CHARGES:	
(per 1,000 gallons)	
5/8" x ¾" Meter – All Classes	
0 - 3,000 gallons	$8.48
3,001 – 9,000 gallons	12.65
Over 9,000 gallons	15.19
¾" Meter – All Classes	
0 - 3,000 gallons	$8.48
3,001 – 9,000 gallons	12.65
Over 9,000 gallons	15.19
1" Meter – All Classes	
First 12,000 gallons	$12.65
Over 12,000 gallons	15.19

1 ½" Meter – All Classes	
First 40,000 gallons	$12.65
Over 40,000 gallons	15.19
2" Meter – All Classes	
First 60,000 gallons	$12.65
Over 60,000 gallons	15.19
3" Meter – All Classes	
First 130,000 gallons	$12.65
Over 130,000 gallons	15.19
4" Meter – All Classes	
First 200,000 gallons	$12.65
Over 200,000 gallons	15.19
6" Meter – All Classes	
First 415,000 gallons	$12.65
Over 415,000 gallons	15.19
Standpipe (all usage)	$10.35

173. Under these authorized rates, the typical residential 3/4-inch bill with a median usage of 3,500 gallons would increase from $35.30 to $67.72, an increase of $32.42, or 91.83 percent.

B. Wastewater Division

174. The Company, RUCO, and Staff proposed the following rates and charges for the Water Division based on their respective revenue requirements:

		Proposed Rates		
	Current Rates	Company	RUCO	Staff
MONTHLY USAGE CHARGE:				
(All Classes)				
5/8" x ¾" Meter	N/A	$52.00	N/A	$50.00
¾" Meter	N/A	52.00	N/A	65.00
1" Meter	N/A	130.00	N/A	150.00
1 ½" Meter	N/A	260.00	N/A	350.00
2" Meter	N/A	416.00	N/A	400.00
3" Meter	N/A	832.00	N/A	600.00
4" Meter	N/A	1,300.00	N/A	800.00
6" Meter	N/A	2,600.00	N/A	1,000.00

COMMODITY CHARGE:
(per 1,000 gallons)

Residential	$5.84	$4.96	$10.86	$0.00
Commercial and Industrial				
Car washes, Laundromats, Commercial, and Manufacturing	$5.71	$4.85	$10.62	$11.61
Hotels and Motels	7.66	6.51	14.25	11.61
Restaurants	9.46	8.04	17.60	11.61
Industrial Laundries	8.39	7.13	15.61	11.61
Waste haulers	171.20	145.52	318.43	11.61
Restaurant grease	149.80	127.33	278.63	11.61
Treatment plant sludge	171.20	145.52	318.43	11.61
Mud sump waste	535.00	454.75	995.10	11.61

175. The Company's existing rate design for the Wastewater Division has no provision for monthly minimum charges. The Company proposed to introduce relatively high minimum monthly charges for all customer classes and to continue collecting commodity rates in the same relative ratios as exist for all customer classes under present rates. The Company's proposed rate design would increase the typical residential 3/4-inch bill with a median usage of 3,500 gallons from $20.44 to $71.59, an increase of $51.15, or 250.22 percent.

176. RUCO proposed to continue the existing rate structure for all customer classes and recover all wastewater revenues through commodity charges. RUCO's proposed rate design would increase the typical residential 3/4-inch bill with median usage of 3,500 gallons from $20.44 to $38.02, an increase of $17.58, or 86.00 percent.

177. Staff proposed to reverse the existing rate design for residential customers and collect all residential revenue from the monthly minimum charges. For non-residential customers, Staff proposed a monthly minimum charge based on meter size and a uniform commodity rate. Staff's recommended rate design would increase the typical residential 3/4-inch bill with a median usage of 3,500 gallons from $20.44 to $65.00, an increase of $44.56, or 218.00 percent.

178. The Company asserted that Staff's rate design will leave the Company without sufficient revenues because it will encourage conservation through high commodity charges for commercial customers. Further, the Company asserted that RUCO's rate design will similarly leave the Company

without sufficient revenues because RUCO is not proposing a monthly minimum charge.[146]

179. RUCO strongly opposed Staff's wastewater rate design by arguing that it does not allow residential customers any opportunity to control their wastewater bills. Further, RUCO argued that Staff's wastewater rate design is inappropriate because it assigns the same commodity rate to all commercial and industrial customers without taking into account the fact that certain commercial and industrial customers place more costs onto the system.[147]

180. Staff argued that commodity charges for residential customers are unnecessary because the Company's customers are already incented to conserve through the water rate design. Staff further argued that it is unreasonable to create added charges to categories of customers without evidence establishing the cost of serving those customers.[148]

Discussion and Analysis

181. While we agree that a minimum monthly charge should be introduced to provide revenue stability, the Company and Staff proposals dispense with an appropriate degree of gradualism. Under the Company's proposal, approximately 70 percent of all wastewater revenue would be generated from the monthly minimum charges of all classes, while Staff's proposal would generate 100 percent of wastewater revenues from the monthly minimum charges of residential customers. Given the relatively high overall increase in revenue adopted herein, we believe that it is appropriate to modify the Company's proposed rate design to reduce the monthly minimum charges and increase the commodity charge, proportionately, to generate 35 percent of the wastewater revenue from the monthly minimum charges. Further, we do not believe it is appropriate at this time to classify commercial and industrial customers into eight separate categories given that the Company only has four commercial wastewater customers. Based on the foregoing, we find the following rates are just and reasonable for the Wastewater Division:

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[146] Company Cl. Br. at 7.
[147] RUCO Cl. Br. at 10.
[148] Staff Rep. Br. at 4.

	Rates
MONTHLY USAGE CHARGE:	
(All Classes)	
5/8" x ¾" Meter	$27.30
¾" Meter	27.30
1" Meter	68.25
1 ½" Meter	136.50
2" Meter	218.40
3" Meter	436.80
4" Meter	682.50
6" Meter	1,365.00

COMMODITY CHARGE:	
(per 1,000 gallons)	
(all usage)	
5/8" x ¾" Meter – Residential	$10.00
5/8" x ¾" Meter – Non-residential	9.78
¾" Meter – Residential	10.00
¾" Meter – Non-residential	9.78
1" Meter – All Classes	9.78
1 ½" Meter – All Classes	9.78
2" Meter – All Classes	9.78
3" Meter – All Classes	9.78
4" Meter – All Classes	9.78
6" Meter – All Classes	9.78

182. Under these authorized rates, the typical residential 3/4-inch bill with a median usage of 3,500 gallons would increase from $20.44 to $62.30, an increase of $41.86, or 204.79 percent.

C. Miscellaneous Service and Installation Charges

183. Staff recommends adoption of its Service Line and Meter Installation Charges and Service Charges for the Water and Wastewater Divisions.[149] The parties did not object to Staff's recommended charges. We find that Staff's recommended charges are reasonable and approve the following Service Line and Meter Installation Charges and Service Charges:

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[149] Staff Final Sch. at JLKW-21 and JLKWW-19.

SERVICE LINE AND METER INSTALLATION CHARGES:

	Service Line Charge	Meter Installation Charge	Total
5/8" x ¾" Meter	$415	$105	$520
¾" Meter	415	205	620
1" Meter	465	265	730
1 ½" Meter	520	475	995
2" Meter/ Turbo	800	995	1,795
2" Meter/ Compound	800	1,840	2,640
3" Meter/ Turbo	1,015	1,620	2,635
3" Meter/ Compound	1,135	2,495	3,630
4" Meter/ Turbo	1,430	2,570	4,000
4" Meter/ Compound	1,610	3,545	5,155
6" Meter/ Turbo	2,150	4,925	7,075
6" Meter/ Compound	2,270	6,820	9,090

SERVICE CHARGES:

Establishment	$20.00
Re-Establishment (Within 12 Months)	(a)
Reconnection (Delinquent)	$50.00
Meter Test (If Correct)	$20.00
Deposit	(b)
Deposit Interest	(b)
NSF Check	$20.00
Late Payment Penalty (Per month)	1.50%
Deferred Payment (Per month)	1.50%
Meter Reread (If Correct)	$10.00
After Hours Service Charge	$40.00
Moving Meter at Customer Request	Cost

(a) Minimum charge times number of full months off the system per A.A.C. R14-2-403(D), R14-2-603(D).

(b) Per A.A.C. R14-2-403(B), R14-2-603(B).

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax per A.A.C. R14-2-409(D)(5), R14-2-608(D)(5).

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IX. OTHER ISSUES

A. Hook-up Fees

184. At the hearing, RUCO and Mr. Nielsen presented evidence that Utility Source collected an unauthorized hookup fee from a customer on April 22, 2014.[150] Mr. McCleve testified that Ms. Parry incorrectly informed the customer that a required hook-up fee was required for the provision of service.[151] Testifying further, Mr. McCleve stated that neither he nor Ms. Parry are aware of any other instance in which Utility Source has collected hook-up fees since the Company's last rate case.[152] Mr. McCleve affirmed that the Company would immediately refund the unauthorized hook-up fee to the customer.[153]

185. On May 20, 2015, the Company filed notice that it issued a refund of the hook-up fee to the customer on May 6, 2015.

186. There is no evidence suggesting that Utility Source has collected additional hook-up fees (other than the hook-up fee discussed above) since the Company's last rate case. Given that the Company has already refunded the unauthorized hook-up fee to the customer, we decline to take any further action. However, we put the Company on notice that any further collection of hook-up fees from customers may result in penalties and sanctions in a future proceeding.

B. Water System Pressure and Supply Issues

187. At the hearing, Mr. Fallon and Staff expressed concern regarding the ability of the Company to provide consistent and adequate fire flow and water pressure.[154] Mr. Fallon introduced into evidence several instances in which the water system experienced prolonged water supply outages as a result of a power outage.[155] To address the fire hydrant flow and pressure failures, as well as the unknown impact that the standpipe operation will have on the water distribution system, Staff recommends that the Company conduct an engineering analysis to determine the water system responsiveness to high water demand events.[156]

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[150] Tr. at 251-53; Exh. RUCO-2.
[151] Tr. at 251-52.
[152] *Id.*
[153] Tr. at 251-52.
[154] Exh. S-2 at 4.
[155] Exh. Fallon-2 at 2-3.
[156] Exh. S-2 at 5.

188. Mr. McCleve testified that there were two water supply outages during the 12 months preceding the hearing date.[157] Testifying further, Mr. McCleve explained that in both instances the backup generator failed to automatically turn on, resulting in water supply outages.[158] According to Mr. McCleve, the backup generator has since been repaired and the water supply issues have been resolved.[159] As a result, the Company argued that performing an engineering analysis on the water system is unnecessary.[160]

189. Even though the Company has repaired its backup generator, we remain concerned that the introduction of the standpipe operation may have an adverse effect on the overall safety and reliability of the water system.[161] Thus, we find that Staff's recommendation is reasonable and appropriate and order the Company to file, within 90 days of the effective date of this decision, documentation demonstrating that an engineering analysis has been conducted on the water system, in a manner acceptable to Staff, with any corrective action recommended from the analysis having occurred prior to filing that documentation.

C. Best Management Practice Tariffs ("BMPs")

190. The Company objects to Staff recommendation that Utility Source adopt at least five BMPs as a compliance item in this matter.

191. Consistent with previous Commission decisions where a utility has objected to the implementation of BMPs, we find that it is not in the public interest, at this time, to require the Company to adopt BMPs and file the related tariffs as recommended by Staff.

D. Mobile Home Park

192. At the hearing, Mr. McCleve testified that the Company is currently serving a mobile home park that is not within the Company's current certificated area.[162]

193. Mr. Nielsen and RUCO argued that the Company should be required to file an

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[157] Tr. at 134-35.
[158] *Id.*
[159] Tr. at 34-35.
[160] *Id.*
[161] According to Staff's engineering analysis, the standpipe facility is connected to the Company's main distribution system, which effectively means that all wells will be used to support water delivery through the standpipe facility. (Exh. S-7 at 2).
[162] Tr. at 124-25.

application for an extension of its CC&N territory to cover the mobile home customers currently being served by Utility Source.[163] Mr. McCleve testified that the Company would not oppose filing an application to extend its CC&N to encompass the territory occupied by the mobile home park.[164]

194. We find that it is reasonable and appropriate to require the Company to file an application to extend its CC&N to cover the territory occupied by the mobile home park within 120 days of the effective date of this Decision.

E. Construct Fencing Around Deep Well No. 2

195. Staff recommends that the Company construct a security fence around Deep Well No. 2. Mr. McCleve testified that the Company has agreed to construct the security fence recommended by Staff.[165]

196. We find that Staff's recommendation is reasonable and should be adopted.

F. Repair Wastewater Treatment Plant Mixed Media Filter

197. Staff recommends that the Company repair the mixed media filter at the wastewater treatment plant. Mr. McCleve testified that the Company has agreed to fix the mixed media filter at the wastewater treatment plant.[166]

198. We find that Staff's recommendation is reasonable and should be adopted.

G. Commission Approval to Sell Deep Well No. 4

199. In the event that the Commission approves the removal of Deep Well No. 4 from rate base, Staff recommends that the Company be required to obtain Commission approval prior to any sale of Deep Well No. 4.[167] According to Staff, Deep Well No. 4 is an extremely valuable asset for the Company.[168] Staff expressed concern that if the Company sells Deep Well No. 4, the Company would need to drill another well, at the expense of the ratepayers, to meet the expected customer growth if Flagstaff Meadows III is ultimately developed.[169]

200. Mr. McCleve testified that the Company does not oppose Staff's recommendation, even

[163] Nielsen Rep. Br. at 9; RUCO Cl. Br. at 14-15.
[164] *Id.*
[165] Tr. at 36-37.
[166] *Id.*
[167] Exh. S-2 at 3.
[168] Tr. at 725.
[169] *Id.* at 721-722.

though Utility Source has no intention of selling Deep Well No. 4.

201. We find that Staff's recommendation is reasonable and should be adopted.

H. Penalties and Sanctions for Alleged Noncompliance

202. In his Reply Brief, Mr. Nielsen recommended that the Commission lodge penalties and sanctions against Company for alleged noncompliance with various Commission rules, regulations, and orders.[170]

203. According to Staff, the Company has no delinquent compliance issues with the Commission.[171] We therefore decline to adopt the penalties and sanctions urged by Mr. Nielsen.

X. RESOLUTION

204. Based on the record in this proceeding, Utility Source's FVRB for its Water Division is $1,499,779.

205. Based on the record in this proceeding, Utility Source's FVRB for its Wastewater Division is $825,880.

206. In the test year, Utility Source's Water Division had adjusted operating income of $6,920, on total adjusted test year revenues of $206,184, for a rate of return of 0.46 percent.

207. In the test year, Utility Source's Wastewater Division had adjusted operating loss of $(77,310), on total revenues of $119,464, for no rate of return.

208. Based on the record of this proceeding, the Company has a capital structure consisting of 100 percent equity, with a cost of equity of 9.80 percent.

209. Based on the record in this proceeding, a fair value rate of return of 9.80 percent will provide Utility Source with a reasonable and appropriate return on its investment and will result in just and reasonable rates.

210. Based on a FVRB of $1,499,779 for the Water Division and an authorized fair value rate of return of 9.80 percent, Utility Source is entitled to a revenue increase of $383,788, or 86.14 percent, over test year revenues.

211. Based on a FVRB of $825,880 for the Wastewater Division and an authorized fair value

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[170] Nielsen Rep. Br. at 9-11.
[171] Tr. at 750-51; Exh. S-7 at 3.

rate of return of 9.80 percent, Utility Source is entitled to a revenue increase of $309,507, or 159.08 percent, over test year revenues.

212. The rates and charges authorized herein are reasonably calculated to provide the Company to earn its authorized revenue requirement and are fair and reasonable.

213. As discussed herein, the adopted rate designs for the Water and Wastewater Divisions are reasonable and in the public interest and should therefore be adopted.

214. It is reasonable and in the public interest to require the Company to file biannual standpipe sales volume reports, as discussed herein.

215. It is reasonable and in the public interest to require the Company to file its next general rate case no later than September 31, 2019, with a test year ending December 31, 2018, as discussed herein.

216. It is reasonable and in the public interest to require the Company to file, within 90 days of the effective date of this Decision, documentation that the Company has performed an engineering analysis on its water system, as discussed herein, and taken any corrective action recommended from that analysis.

217. It is reasonable and in the public interest to require the Company to file, within 120 days of the effective date of this Decision, an application to extend its CC&N to cover the mobile home park adjacent to its existing service territory, as discussed herein.

218. It is reasonable and in the public interest to require the Company to install a security fence around Deep Well No. 2 and file, within 90 days of the effective date of this Decision, documentation that the security fence has been installed, as discussed herein.

219. It is reasonable and in the public interest to require the Company to repair the mixed media filter at the wastewater treatment plant and file, within 90 days of the effective date of this Decision, documentation that the mixed media filter has been repaired, as discussed herein.

220. It is reasonable and in the public interest to require the Company to obtain Commission approval prior to any sale or transfer of Deep Well No. 4, as discussed herein.

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CONCLUSIONS OF LAW

1. Utility Source, LLC is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-250 and 40-251.

2. The Commission has jurisdiction over Utility Source, LLC and the subject matter of the amended application.

3. Notice of the amended application was provided in the manner prescribed law.

4. The rates, charges, and conditions of service established herein are just, reasonable, and in the public interest.

ORDER

IT IS THEREFORE ORDERED that Utility Source, LLC shall file with Docket Control, as a compliance item in this docket, no later than September 31, 2015, revised schedules of rates and charges consistent with the discussion herein.

IT IS FURTHER ORDERED that the revised schedules of rates and charges shall be effective for all service provided on or after October 1, 2015.

IT IS FURTHER ORDERED that Utility Source, LLC shall notify its customers of the revised schedules of rates and charges authorized herein, and their effective date, in a form acceptable to the Commission's Utilities Division, by means of an insert in its next regularly scheduled billing or as a separate mailing.

IT IS FURTHER ORDERED that Utility Source, LLC shall file its next general rate case no later than September 31, 2019, with a test year ending December 31, 2018.

IT IS FURTHER ORDERED that Utility Source, LLC shall file with Docket Control, as a compliance item in this docket, biannual standpipe sales volume reports, as discussed herein, no later than September 31 and March 31 of each year, with the first report due no later than September 31, 2015. We direct the Commission's Utilities Division to review the standpipe sales volume reports and make additional recommendations to the Commission, as necessary.

IT IS FURTHER ORDERED that Utility Source, LLC shall file, within 120 days of the effective date of this Decision, an application with the Commission for approval to extend its Certificate of Convenience and Necessity to cover the mobile home park adjacent to its existing service territory, as discussed herein.

IT IS FURTHER ORDERED that Utility Source, LLC shall install a security fence around Deep Well No. 2 and file, as a compliance item in this docket, within 90 days of the effective date of this Decision, documentation demonstrating that the security fence has been installed.

IT IS FURTHER ORDERED that Utility Source, LLC shall repair the mixed media filter at its wastewater treatment plant and file, as a compliance item in this docket, within 90 days of the effective date of this Decision, documentation demonstrating that the mixed media filter has been repaired.

IT IS FURTHER ORDERED that Utility Source, LLC shall obtain Commission approval prior to any sale or transfer of Deep Well No. 4.

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IT IS FURTHER ORDERED that, in addition to the collection of its regular rates and charges, Utility Source, LLC shall collect from its customers a proportionate share of any privilege, sales or use tax per A.A.C. R14-2-409(D) and R14-2-608(D).

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN | COMMISSIONER

COMMISSIONER | COMMISSIONER | COMMISSIONER

IN WITNESS WHEREOF, I, JODI JERICH, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this ______________day of __________________ 2015.

JODI JERICH
EXECUTIVE DIRECTOR

DISSENT ________________________

DISSENT ________________________
SMH:tv(ru)

SERVICE LIST FOR: UTILITY SOURCE, LLC

DOCKET NO.: WS-04235A-13-0331

Steve Wene
MOYES SELLERS & HENDRICKS LTD.
1850 North Central Avenue, Suite 1100
Phoenix, AZ 85004
Attorneys for Utility Source, LLC

Daniel W. Pozefsky
Chief Counsel
Residential Utility Consumer Office
1110 West Washington, Suite 220
Phoenix, AZ 85007

Erik Nielsen
4680 N. Alpine Dr.
PO Box 16020
Bellemont, AZ 86015

Terry Fallon
4561 Bellemont Springs Drive
Bellemont, AZ 86015

Janice Alward, Chief Counsel
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, AZ 85007

Thomas Broderick, Director
Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, AZ 85007