OPEN MEETING AGENDA ITEM

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BEFORE THE ARIZONA CORPORATION CC

EXCEPTION

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

Docket No. WS-01303A-14-0010

Arizona Corporation Commission
DOCKETED
AUG 17 2015
DOCKETED BY

RUCO'S EXCEPTIONS

The RESIDENTIAL UTILITY CONSUMER OFFICE ("RUCO") hereby files the following Exceptions to the Recommended Opinion and Order ("ROO") in the matter of EPCOR WATER ARIZONA, INC.'s ("EPCOR" or the "Company") application for a revenue increase.

INTRODUCTION

Is there any circumstance that one could possibly think of where ratepayers should pay the Company over eight times more than the Company paid for its plant? There is example after example of the Company's over-recovery of $4,358,319, per the ROO, through excess depreciation expense in this case which in part explains the discrepancy, along with the post-test year plant between RUCO and the ROO's revenue requirement recommendations. In addition to recovering excessive depreciation expense from ratepayers there is $3,135,642 that is identified in the ROO as debit accumulated depreciation balances that unfairly increases the rate base allowing an additional return to the ratepayers. The ROO highlights the depreciation issues and debit balances and takes a step towards correcting them but falls far short. For the following reasons, RUCO believes the accumulated depreciation balances should be as follows:

RECOMMENDED

	per ROO	per RUCO	Difference
Debit Accu. Depre.Balances	$3,135,642	$2,658,304	$477,338 (1)
Credit Excess Accumulated Depreciation Balances	$4,358,319	$5,266,591	$908,272 (2)
NET DIFFERENCES	$1,222,677	$2,608,287	$1,385,610

(1) See Paradise Valley Organization Costs debit Accumulated Depreciation Balance

(2) ROO Excluded the Arizona Corporate over depreciated plant assets

While the ROO reduces rate base by $1,222,677, RUCO believes the rate based should be reduced by an additional $1,385,610 for a total reduction of $2,608,287 due to the ROO's exclusion of the organizational costs and the over depreciated Arizona Corporate assets. While the ROO discusses the over depreciation of Company assets and has set up regulatory liabilities for future amortization -the ROO has also allowed the company to continue to depreciate these assets going forward even though the Company agreed to discontinue this excessive depreciation practice[1].

The ROO offers no good explanations to allow for this over-reach. No prior Commission has required this Commission to approve the over-recovery. This Commission has not approved it or even suggested it would be approved in the past. No – there is no reason why the Company

[1] ROO at page 18 (lines 1-4). RUCO does think that the ROO's approach is a step in the right direction but falls short of providing sufficient relief to the ratepayers.

should be allowed to recover excess depreciation and debit balances due primarily to errant accounting practices. There is also no good reason why the ratepayers should not be credited for the negative impact it has on rates by amortizing the ROO's regulatory assets and liabilities to test year depreciation expense.

The negative impact on the ratepayer is further highlighted by the ROO's generous post-test year plant recommendation for the Company which will otherwise expand the criteria for allowable post-test year plant – approximately $12.5 million in this case – and, of course, the generous recommendation to approve a $28 million SIB. Simply stated, if the ROO is approved, the Company will get an approximate $3.4 million yearly revenue increase on a $4.4 million request plus a $28 million SIB. The ratepayer will get some scraps in a case which can best be described as absurd and should have been dismissed.

<u>THE REGULATORY ASSETS AND LIABILITIES SHOULD BE AMORTIZED TO TEST YEAR OPERATING EXPENSE</u>

The above example is not exaggerated or out of line with other examples which, if overlooked, would be a real travesty to the ratepayer. RUCO presented two exhibits. See attached Exhibit 1 (with the actual Company plant schedule for the above example) and Exhibit 2. Both exhibits were produced from the Company's schedules and the numbers are not in dispute. The first exhibit shows over $5.4 million dollars in over-depreciated assets. Account No. 341100 (highlighted) in the Mohave Water District shows Transportation Equipment with a plant balance of $99,015 and a Credit Accumulated Depreciation Balance of $808,721 – or more than eight times the cost of the plant. In the Sun City District, Account No. 341100 Transportation

Equipment had a plant balance of $976,241 with a final[2] accumulated depreciation balance of $3,021,077. The total amount of over-recovery – recommended by the ROO on this one account alone is $2,044,836! The ROO mentions that such balances are confusing to understand, but with all due respect there is nothing complicated about it – the Company is going to recover a lot more revenue than it should and whatever the reason - and there is no good one, ratepayers are going to have to over-pay for it with higher rates.

The attached Exhibit 2 shows approximately $5.9 million of Accumulated Depreciation "Debit" balances. The ROO recognizes that these type of balances create "...undesirable, intergenerational transfers of costs." They add "inefficiencies" and perhaps worst of all is they continue to add to the rate base raising ratepayers' rates if and until they are addressed. In this case, there are close to 35 debit accumulated depreciation balances, which are essentially plant assets as they reduce the accumulated depreciation balances and have been continually and unnecessarily increasing the rate base in some cases going back to 2004 and earlier.

A more detailed look at these "debit" balances highlight the unfairness to the ratepayer should the Commission approve this approach. In the Mohave, Paradise Valley, Sun City Water and Tubac districts there is at least one account where the Company has depreciation balances with a zero percent depreciation rate. One must ask how it is even possible to have depreciation balances where the depreciation rate is zero. The product of any number times zero is zero. Common sense aside, the ROO mentions one particular account in Paradise Valley where the debit balance was ($477,338). This account had a debit accumulated depreciation balance of ($477,338) as of 12/2004. The ROO recognizes that the "...Company failed to properly record

[2] "Final" in the sense that this is the balance as of this rate case – the Commission has yet to decide the fate of this balance beyond this rate case.

plant transfers in the Paradise Valley District." This particular transaction, notes the ROO, according to NARUC USOA should have been submitted to the Commission for confirmation of the proper treatment – which it was not. The explanation offered by the Company as recited in the ROO was there was a discrepancy between the Company's accounting ledger and the fixed accounting system's accumulated depreciation balance. This is the Company's support for an entry that RUCO has shown on the record has cost ratepayers $590,288 over a ten-year period - so yes it did provide the Company with an "economic advantage," the Company more than recovered the "discrepancy" through a return on the $477,338 over the 10 year period. The Company should not be earning a return on this fully recovered "supposed" asset and should be required to remove the balance from its plant accounts.

The ROO justifies its recovery based on the fact that the Company's "...cumulative earnings have not provided EPCOR with a return of its investment..." Really...this Company has paid out $23,962,545 in dividend payments, or 80.31 percent of its earnings of $29,837,000 since purchasing this system in 2012 and the concern is the Company's earnings? Additionally, the Company already recovered the "discrepancy" and then some and the ROO recommends that it stay in rate base and continue to earn a return. It would be an unfortunate day for the ratepayers if the Commission approves recovery here.

Specific examples of the over-recovery of depreciation abound and RUCO would refer the reader to its Closing and Reply Briefs for further explanations but the point could not be more clear – the Commission must provide the Company's ratepayers with some type of financial relief now for the Company's over-recovery of depreciation in this case. Approval of the ROO would violate the Commission's own Rule on Depreciation - A.A.C. R-14-2-102(A)(3) defines "Depreciation" as an accounting process that will allow a company to recover its original cost less its net savage value over its service life. The Rule does not allow a company to collect its cost many times over.

RUCO is in the process of fashioning a proposed amendment to the ROO which it believes would be more than fair under the circumstances of this case. RUCO is not seeking an adjustment based on the entirety of the Company's over-depreciation, but a portion of it – the most egregious examples. RUCO intends to supplement these Exceptions with all of its proposed amendments prior to the Open Meeting on this matter.

THE COMMISSION SHOULD REJECT THE INCLUSION OF RECURRING PROJECTS IN APPROVED POST TEST YEAR ("PTY") PLANT

Recurring Projects ("RPs") are the smaller, routine projects which the Commission has typically denied as part of PTY plant. In this case, RP's account for approximately $5.6 out of a total of $12.2 million of PTY plant. RUCO does not object to the other $6.6 million of PTY plant which includes the larger projects. RUCO does object to the inclusion of the smaller projects. Including the RP's further distorts the meaning of operating income and rate of return for measuring fair and reasonable rates as this Commission understood and recognized in the Company's last rate case (Decision No. 71410) – nothing has changed since then.

If the goal here is to address the Company's under-earnings no matter what the previous underlying rationale/tradition is, then the ROO strikes the right chord. In the Company's last case, the Commission adopted Staff's approach on post-test year plant which explained why from a regulatory concept adherence to the matching principle is a fundamental regulatory principle and the absence of this principle "distorts" the meaning of operating income and rate of return leading to less fair and reasonable rates. It is the matching principle that underlies the Commission's traditional approach of only allowing post-test year plant in "special and unusual" circumstances. The Commission's traditional approach of allowing PTY plant, as outlined by Staff, occurs when:

1) the magnitude of the investment relative to the utility's total investment is such that not including the post-test year plant in the cost of service would jeopardize the utility's financial health;

2) the cost of the post-test year plant is significant and substantial;

3) the net impact on revenue and expenses for the post-test year plant is known and insignificant (or is revenue-neutral); and

4) the post-test year plant is prudent and necessary for the provision of services and reflects appropriate, efficient, effective, and timely decision-making.

Well, the RP's are small, routine, relatively unsubstantial and do not meet the above criteria on several levels so now the ROO suggests the Commission toss that criteria aside and allow the inclusion of the $5.5 million in RP's because the Commission in the *Chaparral* Decision (Decision No. 74568) included PTY plant based on Staff's verification of in-service, and used and useful. Apparently the distortion caused by the mismatch and the effect on the reasonableness of the rates is no longer a consideration or concern – the earnings goal must be. RUCO recommends the Commission reject the ROO's recommendation to include the RPs in ratebase.

THE COMMISSION SHOULD REJECT THE SIB

EPCOR has requested SIB projects totaling $28,246,638 be approved for Sun City Water District, Mohave Valley Water District and Paradise Valley Water District. The increase in total revenues generated from SIB projects is 2 percent more than the revenues being recommended in the ROO for the three affected systems in the underlying rate case.

RUCO's engineering review indicated that the projects included in EPCOR's request are not justifiable and should not be approved by the Commission in this case. For example, the program proposed under the SIB with respect to meters, services and valves is much more aggressive than history suggest it needs to be. The proposed number of valves targeted for replacement is more than triple the historic replacement rate. For services the Company proposes to double the average amount of services being replaced as compared to historic levels. The Company reports that it has replaced over 4,000 meters on average in the last two years in the Mohave Water and Sun City Water Districts. Under the SIB, it proposes to replace just over 4,000 per year. Obviously, since the Company is already replacing meters at a rate greater than what is being requested under the SIB there is no special need for a SIB for meter replacements in order to provide better service. Moreover, a review of the SIB reports for each of these Districts shows that the justification for the meter replacement is to improve meter accuracy. Increasing meter accuracy will result in increased revenues to the Company. Without an offering of sharing the increased revenues with the ratepayers, this is unfair and a clear violation of the matching principal. The SIB is not justifiable on an engineering basis and the proposed program is being done out of desire to reduce losses and grow revenues and net income and not needed for repairs.

In addition to those issues that are specific to this case RUCO has opposed a SIB mechanism in past rate case applications, and continues to oppose a SIB mechanism, for the following reasons:

1. the SIB inappropriately shifts risk from the Company to the ratepayer without adequate financial compensation to the ratepayer;
2. the SIB is not an adjustor mechanism;

3. the SIB will increase the Company's fair value rate base without any determination of fair value;

4. the Company has not requested interim rates;

5. the SIB is not in the public interest;

6. individual circumstances of the case; and

7. the Company does not set aside depreciation expense.

The ROO's reasoning for the recommended approval of the SIB is consistent with the Commission's findings in AWC's Eastern Division case (Decision No. 73938). The ROO refers to the comprehensive discussion in that case. RUCO's legal and regulatory positions have been set forth at length as part of that discussion as well as in the AWC's Northern Division case (Decision No. 74081). The underlying record in this case also sets forth in grand and vivid detail the basis for RUCO's opposition. RUCO would refer the Commission to those documents as they pertain to the SIB should there be any question.

UNEXPENDED CIAC

The Commission has recently changed its policy on unexpended CIAC to a position where it becomes a deduction to rate base only when the plant is in service and used and useful. CIAC is developer funded money that until recently has been a deduction against rate base when the contribution is made by the developer. Contributions are not utility based funds – they are third-party, developer based funds. RUCO has opposed this new Commission policy and still believes it is misguided and wrong – the Commission should not distinguish CIAC and apply different accounting rules to CIAC depending on the when plant goes in service.

Nonetheless, the Commission continues to approve this policy and the ROO recommends it continue. It is noteworthy that the logic of the ROO to support the Commission's concern is the "mismatch" between deductions from rate base related to the plant not in service. This same regulatory concept of matching, however, does not appear to matter or no longer be a concern when it comes to the ROO's view on post-test year plant – see above. It is also noteworthy that in both instances – the recommended view benefits the Company at the expense of the ratepayer.

RUCO has asked, at a minimum, that the Commission require companies to use separate bank accounts to deposit and track the developer supplied cash should the Commission insist on this new approach. In that manner, the Commission can be assured that the Company is using the money for its intended purpose. There are still some utility companies in Arizona, Black Mountain Sewer Company for example that account for CIAC under the new Commission policy by placing the funds in separate interest bearing accounts. EPCOR has admitted that once the CIAC monies are deposited to the Company's general cash account it does not know where the money goes. These funds could be submitted as dividends to its Canadian parent; or it may be used to pay for some operating expenses, in which case the Company has double recovered through the ratepayers. Without explanation, the ROO dismisses this minimal safeguard that, in the absence of, will force RUCO and Staff to "chase" these CIAC funds in future rate case applications. RUCO recommends that the Commission treat all CIAC as a reduction to rate base when it is paid, or at the very least require the Company to deposit the contribution in an interest bearing account and track it.

REVENUE ANNUALIZATION

The purpose of revenue annualization is to match the customer count to the revenue request. The customer count is based on the test year average or the test year end count. The choice of which customer count to use will effect revenues and depending on the choice a

Company can manipulate a favorable outcome. In this case, the Company has chosen to annualize its revenues using an average customer count.

In fact, using the average count methodology would result in a reduction of test year revenues of ($11,850) – necessitating a higher revenue requirement and hence higher rates. The average count methodology skews the actual number at the end of the test year which is presumed to be the customer count going forward. A brief illustration makes the point. If the Company were to start with one customer and add another customer each month, it would have twelve customers at the end of the year using the end of test year methodology, and six customers using the average count methodology. Twelve customers will be using the system and its resources, not six going forward.

The end of test year customer count has been the method historically used by the Commission. The end of test year approach annualizes the revenue based on the actual customer count at year end which in turn provides more accurate and reasonable rates. There may be other situations where the average count approach is the better approach, such as where there is a mass exodus of customers from the system, or some strange seasonality effect – neither of which have been shown or exist in this case. Using the end of test year methodology, results in a revenue increase of $176,163 or a net change of $188,013 from the Company's methodology which equates to an additional $188,013 that ratepayers have to pay.

The ROO, without explanation, recommends the Company's average count methodology referring to it as "preferable" to the test year end methodology. The Commission should reject the ROO's recommendation and adopt the end of test year methodology which is the better methodology going forward, and comports with the matching principle.

INCENTIVE COMPENSATION

RUCO is concerned with the ROO's recommendation on Incentive Compensation. Staff recommends 50 percent recovery and RUCO recommends zero. The ROO rejects RUCO and Staff's position and awards the Company what it is asking – 90 percent recovery.

The Commission has historically determined that the costs associated with Incentive Plans should be shared to some degree provided there is a showing. The reason is clear - shareholders also benefit from the achievement by its employees of financial goals. Shareholders benefit from the achievement of expense reductions and expense containment goals between rate cases. Shareholders and ratepayers can both benefit from the achievement of customer service goals. The rationale for an allocation to shareholders of utility incentive compensation expense in the current case appears to be consistent with the Commission's findings that shareholders should be responsible for some portion of incentive compensation costs in several rate case decisions.

For the most part the Commission has been consistent in requiring a sharing of some sort but not nearly as generous as the ROO recommends. In *Chaparral* the Commission rejected the Company's request to recover incentive compensation – in other words ratepayers paid zero towards employee incentive compensation. Decision No. 74568. The Commission in other Decisions on this issue, for example, has decided as follows:

- Decision No. 68487 (February 23, 2006) – Southwest Gas – 50/50
- Decision No. 70011 (November 27, 2007) - UNS Electric rate 50/50
- Decision No. 70360 (May 27, 2008) - UNS Electric, Inc. 50/50
- Decision No. 70665 (December 24, 2008) - Southwest Gas Company -50/50
- Decision No. 71410 (May 1, 2012 in Docket No. W-01301A-10-0448) - Paradise Valley Water District- 70/30 (Ratepayer/Shareholder)
- Decision No. 72047 (January 6, 2011 in Docket No. W-01301A-09-0343) - Sun City Water District rates – 70/30

In this case, EPCOR is not justified in charging ratepayers for any of the components of incentive compensation. Ratepayers should not have to pay extra for EPCOR and EWAZ employees for showing up for work and conducting their work in a safe manner.

One component often scrutinized when considering incentive compensation recovery is customer service and customer satisfaction. Here, when the evidence in the record shows that EPCOR's achieved level of customer satisfaction has been poor, it would be inappropriate and unconscionable to charge ratepayers for 90 percent of incentive compensation expense based on this measure.

DECLINING USAGE "ADJUSTOR"

RUCO's disdain for declining usage "adjustor"[3] is an old story. RUCO has been, and remains perplexed, why such an adjustment at the very least is not symmetrical and would provide ratepayers with a refund when use increases. RUCO cannot explain the Commission's past logic nor the ROO's for recommending the approval of such a one-sided adjustment. The logic is even more mystifying when, as the ROO puts it, the rate designs that the Commission has adopted allowing a higher commodity charge for higher usage has resulted in an incentive to conserve water. Now that the ratepayer is incentivized to conserve water the ROO recommends the Commission take that away by making the ratepayers pay for the decline in usage caused by ratepayer conservation.

The ROO in this case misses the boat on other levels. The ROO states that the record in this case shows that residential customer classes are experiencing consistently declining usage.

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[3] RUCO takes issue with the legal term adjustor – RUCO does not believe that it is an adjustor – RUCO refers to it as a "Declining Use Adjustment in its Closing Brief." Among other reasons, the mechanism is not looking at a narrowly defined expense, or an expense at all for that matter.

That is not true – not all the systems have been experiencing declining usage. RUCO has looked at the Company's records and shown where the Paradise Valley Water District has been experiencing increasing usage since the Company's last rate case, and usage has trended upward in the Tubac Water District from 2012 to 2013. RUCO does not make these facts up – they are facts RUCO gathers from the Company's schedules and discovery. These facts should not be overlooked.

The ROO states the decline is likely to continue and has projected this into the future, even though in two of these districts this is not the case. In some of the districts that did experience a decline, the decline was measured back to a 2007 test year. Even if we assume the declining usage continues at the same rate for these other districts, and if the Company refiles a rate case in three years, it is not likely the decline would be as pronounced, and ratepayers will have overpaid.

Another troubling aspect of the ROO's recommendation is how far it strays from the historic approach to address a problem that does not exist in all of its districts. This is made more curious by the fact that the decline from prior test years has already been accounted for in the test year. In *Chaparral* the Commission approved a declining usage adjustment which it also has done in other recent water rate cases. However, in Chaparral the Commission looked at the post-test year declining usage and concluded it had continued and made its adjustment based on known and measureable changes. In this case, the ROO recommends Staff's approach which does not look at post-test year usage, only projections which further assures its inaccuracy to actual usage. The problem with projections is they are just that – estimates – and to the extent they are wrong it is the ratepayer, and not the shareholder who pays.

Even Staff, whose position the ROO relies, at least in part, acknowledged that the Company should submit a Plan of Administration to true-up projected customer usage with actual and measurable usage between and within customer classes. This would protect ratepayers against adverse projections by the Company and Staff. Basically, if customer usage decreases somewhat but not to the level of the projections, stays the same, or increases ratepayers will then overpay through rates. The ROO recommended adjustment provides no protection for the ratepayer – only the Company and should be rejected. Should the Commission approve the ROO, RUCO recommends that the Commission order the Company to submit an annual filing which shows the usage by customer class similar to what the Company was ordered in the *Chaparral* case.

CAP SURCHARGE

The Company has simply ignored the Commission's previous decision on the case. By adopting the Company's position the ROO is legitimizing the behavior. RUCO recommends the Company be required to follow through with the Commission's previous decision to include in base rates the capital and delivery charges and the elimination of the CAP surcharge for the Company's Sun City Water District and the Paradise Valley Water District. In Decision No. 72046 (dated December 19, 2010 - Sun City Water District) the Company was ordered by the Commission to "...include the CAP capital and delivery charges and the offsetting replenishment credits and costs in its base rates" in the Company's next rate case. Similarly in Decision No. 72208 (dated March 3, 2011 - the Paradise Valley Water District) the Company was ordered in its next rate application to file "the inclusion in base rates of the CAP capital and delivery charges and the elimination of the CAP surcharge."

RUCO believes that the Company should be required to do what it was ordered to do. This is the best recommendation since it still makes sense. The Commission should be concerned with companies who do not follow through with what they have been ordered to do.

If the Company disagrees with a prior Commission Decision, it should have appealed it or sought relief prior to now, ignore it and seek to change it in the next case. The Commission should reject the ROO's CAP surcharge recommendation.

POWER COST ADJUSTOR MECHANISM

Adjustor mechanisms are an exception to Arizona's fair value requirement and as such they should be applied narrowly, not broadly. This case is overloaded with adjustors and there is simply not a reason to include power costs which admittingly are not volatile. The ROO rejects the Health Care Cost adjustor and cites as a reason the failure to demonstrate that health care costs are "especially volatile." The ROO points out the lack of evidence in the record to show significant volatility for a Power Cost adjustor but then approves it. Such competing logic is counterintuitive. An adjustor should not be used for every expense – only narrowly defined ones which the Commission has historically said are very large and volatile. See Decision No. 68302. The power costs do not meet the criteria and the adjustor should not be approved.

TUBAC STORAGE TANK

RUCO does not take issue with the ROO on its decision to immediately add storage capacity in Tubac. RUCO does object to keeping the docket open for further consideration.

PROPERTY TAX ASSEMENT RATE

The Commission should approve RUCO's 18.056 percent rate the property tax rate assessment rate is 18.00 percent starting January 1, 2016, as set by Arizona State Law. The ROO recommends using an old property tax assessment rate of 18.50. Assuming three years between rate cases, and anticipating that Company's rates will go into effect by September 1, 2015, barring any more delays, RUCO calculated the average to be 18.056 percent (i.e. 4 months at 18.5 percent and 32 months at 18.0 percent), which is a better measure than the old rate. The ROO's recommended 18.50 tax assessment ratio will be outdated in four months, and ratepayers will be required to pay more than their fair share again.

ACCOUNTING COMPLIANCE ISSUES

The ROO did a good job of itemizing the accounting and reporting concerns in this case. This case was not the first instance – the Company's recent Chaparral city case was replete with instances of accounting errors and poor record keeping. Once again, the ROO acknowledges the many errors and poor record keeping but falls short of doing anything about it. Putting the Company on Notice and telling them they better get their act together in future cases is hollow and weak. The Company was on Notice from the Chaparral case yet it was undeterred.

The Commission needs to do something more substantive here. Failure to do so will just result in similar behavior in the future. There needs to be consequences.

RUCO recommends the following:

1. EPCOR include in all future rate case applications (for all districts) plant schedules that include plant additions, retirements, and accumulated depreciation balances by year and by NARUC plant account number that reconcile to the prior Commission decision.
2. EPCOR file an accounting action plan that will correct its lack of internal controls over its plant schedules and records, within 90 days of a decision in this docket.
3. The adoption of RUCO's recommended rate case expense.

In addition to the above recommendations, RUCO recommends the Commission require EPCOR Water Arizona be audited by an independent external auditing firm and that EPCOR's accounts be reviewed for correctness and accuracy and internal controls be put in place and working.

The ROO did address RUCO's concerns but indicated that "engaging an outside auditor to analyze specific ratemaking accounting issues raised in this case would be costly, and that properly defining the work to be performed by an external CPA itself would be a difficult task. Moreover, even if the scope of such an audit could be properly defined and executed, Staff, RUCO or other parties may not necessarily accept the results produced by an independent CPA." RUCO respectfully disagrees. While RUCO understands there is a cost involved, the savings in this case, had such an audit been done, just in the time alone that it took to review this case would in all likelihood have paid for such an audit. While many errors and deficiencies were noted in this case, RUCO maintains its concern that the accounts are still not properly stated for the systems included in this case.

It also appears by its actions that the Company is in agreement with RUCO's concerns. The Company is using an outside CPA firm to help with its next rate case. See Exhibit 3. The ROO's comment that RUCO may not accept the results of what the CPA firm recommends is misplaced.

RUCO's recommendations are by no means punitive and will move the ball forward in addressing the Company's behavior.

CONCLUSION

For the above reasons, the Commission should approve RUCO's recommendations.

RESPECTFULLY SUBMITTED this 17th day of August, 2015.

Daniel W. Pozefsky
Chief Counsel

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By Cheryl Fraulob

EXHIBIT 1

R-1

OVER-DEPRECIATED ASSETS
PREPARED BY RUCO
ACCOUNTS AND BALANCES PER COMPANY'S REVISED APPLICATION SCHEDULES B-2 LESS EWAZ

Line No.	Districts	Account No.	Depre. Rate	Account Name	UPIS Balance	Accum. Depre. Balance (Dr) / Cr	Over-Collected TY End Depre. Exp.
1	Mohave Water	320100	5.00%	WT Equip Non-Media	97,220	117,502	20,283
2		330100	1.54%	Elevated Tanks & Standpipes	-	3,569	3,569
3		341100	20.00%	Trans Equip Lt Duty Trks	99,015	808,721	709,706
4		342000	4.00%	Stores Equipment	1,420	1,529	109
5		344000	4.00%	Laboratory Equipment	7,623	9,781	2,158
6		345000	5.00%	Power Operated Equipment	171,959	192,293	20,334
7				**Sub-Total for Mohave Water**			756,159
8	Paradise Valley	304100	2.50%	Structures & Improvements Supply	158,547	986,421	827,874
9		340200	10.00%	Computer & Periphal Equipment	38,077	93,695	55,618
10		340300	25.00%	Computer Software	37,405	181,341	143,937
11		341100	20.00%	Transportation Equip Light Duty Truks	(0)	20,414	20,414
12		341300	7.80%	Transportation Equipment Autos	(0)	13	13
13		346100	9.76%	Communication Equipment Non-Telephone	456,755	458,900	2,145
14				**Sub-Total for Paradise Valley**			1,050,000
15	Sun City	304100	2.50%	Structures & Improvements Supply	(98,493)	330,200	428,693
16		332000	1.53%	Fire Mains	0	11	11
17		340300	25.00%	Computer Software	43,402	54,103	10,701
18		341100	20.00%	Transportation Equip Light Duty Truks	976,241	3,021,077	2,044,836
19		341200	15.00%	Transportation Equip Heavy Duty Truks	54,958	64,356	9,398
20		346100	10.30%	Communication Equipment Non-Telephone	218,768	453,077	234,308
21				**Sub-Total for Sun City**			2,727,947
22	Tubac Water	340200	10.00%	Computer & Periphal Equipment	1,336	5,104	3,769
23		341100	20.00%	Transportation Equip Light Duty Truks	17,166	59,578	42,412
24				**Sub-Total for Tubac**			46,181
	AZ-Corporate						
25	**For Total EWAZ**	304620	14.28%	Structures & Improvements Leasehold	217,650	243,821	26,171
26		340300	25.00%	Computer Software	1,839,680	4,971,450	3,131,770
27		340300	25.00%	Computer Software Other	53,132	106,257	53,125
28				**Sub-Total for Allocable AZ-Corporate**			3,211,066
29	AZ-Corporate For 5-Districts in This Case			AZ-Corporate Over-Depreciated for 5-Districts in this Case			908,762
30	GRAND TOTALS			OVER-DEPRECIATED ASSETS FOR FIVE-DISTRICTS IN THIS CASE			5,489,050

Allocation Factors by District for AZ-Corporate Allocable Plant:

Mohave Water	9.80%	Tubac	0.37%
Paradise Valley	2.99%	Mohave Wast	0.88%
Sun City	14.26%		

Total Allocated to the 5-Districts 28.30%

Line No.	Sub. Acct.	Description	Plant Balances at 6/30/13 per ORIGINAL Filing	RB ADJ SLH-10 Beginning Balance Pro Forma	RB ADJ SLH-11 Additional YE Pro Forma	Plant Balances at 6/30/13 per REVISED Filing
1	**Update Plant in Sevice and Accumulated Depreciation**					
2	This adjustment is reflect the proper balances as of June 30, 2013.					
3						
7	301000	Organization	$ 34,004	$ -	$ -	$ 34,004
8	302000	Franchises	37,061	-	-	37,061
9	303200	Land & Land Rights Supply	253,594	-	275,106	528,700
10	303300	Land & Land Rights Pumping	2,351	-	-	2,351
11	303500	Land & Land Rights T&D	9,609	-	-	9,609
12	303600	Land & Land Rights General	47,358	-	-	47,358
13	304100	Structures & Improvements Supply	468,718	-	7,108	475,826
14	304200	Structures & Improvements Pumping	31,201	-	-	31,201
15	304300	Structures & Improvements Treatment	47,846	-	-	47,846
16	304400	Structures & Improvements Trans & Dist	43,546	-	-	43,546
17	304500	Structures & Improvements General	43,231	-	-	43,231
18	304600	Structures & Improvements Offices	449,617	-	-	449,617
19	304700	Structures & Improvements Store,Shop,Gge	29,223	-	-	29,223
20	305000	Collect & Impounding	663,944	-	-	663,944
21	307000	Wells & Springs	2,086,695	(2,134)	-	2,084,561
22	309000	Supply Mains	93,481	-	-	93,481
23	310000	Power Production Equipment	50,355	-	-	50,355
24	311000	Pumping Equipment Steam	409,521	-	-	409,521
25	311200	Pumping Equipment Electric	2,801,352	(2,781)	(20,659)	2,777,913
26	311500	Pumping Equipment Other	1,009	-	-	1,009
27	320100	Water Treatment Equipment Non-Media	97,220	-	-	97,220
28	330000	Distribution Reservoirs & Standpipes	2,832,819	-	-	2,832,819
29	330100	Elevated Tank & Standpipes	-	-	-	-
30	331001	TD Mains Not Classified by Size	105,048	-	-	105,048
31	331100	TD Mains 4in & Less	11,977,017	-	31,802	12,008,818
32	331200	TD Mains 6in to 8in	3,770,441	(113,753)	(0)	3,656,688
33	331300	TD Mains 10in to 16in	989,225	4,998	0	994,223
34	331400	TD Mains 18in & Grtr	76,265	-	-	76,265
35	333000	Services	6,976,912	26,696	(125,594)	6,878,014
36	334100	Meters	2,425,994	-	59,185	2,485,178
37	334200	Meter Installations	276,524	-	(169)	276,354
38	335000	Hydrants	162,044	16,832	6,526	185,402
39	339200	Other P/E-Supply	82,583	-	-	82,583
40	339600	Other P/E-CPS	179,702	-	-	179,702
41	340100	Office Furniture & Equipment	101,669	-	-	101,669
42	340200	Computer & Periphal Equipment	109,956	-	-	109,956
43	340300	Computer Software	3,521	-	-	3,521
44	341100	Transportation Equip Light Duty Truks	99,015	-	-	99,015
45	341200	Transportation Equip Heavy Duty Truks	72,088	-	(0)	72,088
46						
47	Workpapers and Supporting Documents:		(continue on page 2 of 4)			
48	B-2 Revised					
49						
50	\2013 Mohave Water Sch. A-F Oct2014.xls					

Update Plant in Sevice and Accumulated Depreciation

This adjustment is reflect the proper balances as of June 30, 2013.

Sub. Acct.	Description	Acc Dep Balances at 6/30/13 per ORIGINAL Filing	RB ADJ SLH-10 Beginning Balance Pro Forma	RB ADJ SLH-11 Additional YE Pro Forma	Acc Dep Balances at 6/30/13 per REVISED Filing
301000	Organization	$ -	$ -	$ -	$ -
302000	Franchises	-	-	-	-
303200	Land & Land Rights Supply	-	-	-	-
303300	Land & Land Rights Pumping	(10)	-	0	(10)
303500	Land & Land Rights T&D	-	-	-	-
303600	Land & Land Rights General	-	-	-	-
304100	Structures & Improvements Supply	215,046	5,936	(149)	220,832
304200	Structures & Improvements Pumping	(224)	-	(2)	(225)
304300	Structures & Improvements Treatment	19,602	-	146	19,748
304400	Structures & Improvements Trans & Dist	6,052	-	45	6,097
304500	Structures & Improvements General	4,108	-	(92)	4,016
304600	Structures & Improvements Offices	136,745	-	1,021	137,766
304700	Structures & Improvements Store,Shop,Gge	13,482	-	101	13,582
305000	Collect & Impounding	259,605	-	1,938	261,543
307000	Wells & Springs	624,067	(32,607)	(56,866)	534,594
309000	Supply Mains	5,678	-	39	5,717
310000	Power Production Equipment	22,862	8,314	(15,591)	15,586
311000	Pumping Equipment Steam	12,745	-	(1,297)	11,448
311200	Pumping Equipment Electric	1,950,831	(79,501)	(18,866)	1,852,465
311500	Pumping Equipment Other	276	-	(6)	270
320100	Water Treatment Equipment Non-Media	114,896	-	2,607	117,502
330000	Distribution Reservoirs & Standpipes	631,794	5,959	(10,743)	627,010
330100	Elevated Tank & Standpipes	-	-	3,569	3,569
331001	TD Mains Not Classified by Size	6,415	-	(2,341)	4,075
331100	TD Mains 4in & Less	6,297,528	-	176,076	6,473,604
331200	TD Mains 6in to 8in	473,743	3,980	14,866	492,589
331300	TD Mains 10in to 16in	34,855	67	14,325	49,247
331400	TD Mains 18in & Grtr	6,493	-	320	6,813
333000	Services	2,720,617	356	34,069	2,755,043
334100	Meters	824,160	-	(2,569)	821,591
334200	Meter Installations	99,853	-	(3,181)	96,672
335000	Hydrants	10,833	225	1,496	12,554
339200	Other P/E-Supply	(45,816)	-	54,944	9,128
339600	Other P/E-CPS	32,672	-	(136)	32,535
340100	Office Furniture & Equipment	(6,372)	-	453	(5,919)
340200	Computer & Periphal Equipment	(248,940)	-	(5,681)	(254,621)
340300	Computer Software	1,108	-	360	1,468
341100	Transportation Equip Light Duty Truks	799,246	-	9,475	808,721
341200	Transportation Equip Heavy Duty Truks	31,913	(2,687)	14	29,241

Workpapers and Supporting Documents:

(continue on page 4 of 4)

B-2 Revised

\2013 Mohave Water Sch. A-F Oct2014.xls

EXHIBIT 2

R-2

ABNORMAL / DEBIT ACCUMULATED DEPRECIATION BALANCES SCHEDULE
PREPARED BY RUCO
ACCOUNTS AND BALANCES PER COMPANY'S REVISED APPLICATION SCHEDULES B-2

Line No.	Districts	Account No.	Depre. Rate	Account Name	UPIS Balance	Debit TY End A/D Balances (Dr) / Cr
1	Mohave Water	303300	0.00%	Land & Ld Rights Pumping	$ 2,351	$ (10)
2		304200	2.00%	Struct & Imp Pumping	31,201	(225)
3		340100	4.50%	Office Furniture & Equip	101,669	(5,919)
4		340200	10.00%	Comp & Periph Equip	109,956	(254,621)
5		346200	10.00%	Comm Equip Telephone	-	(10,833)
6		346300	10.00%	Comm Equip Other	5,111	(6,235)
7				**Sub-Total for Mohave Water**		**$ (277,844)**
8	Paradise Valley	301000	0.00%	Organization	1,831	$ (477,283)
9		304200	3.99%	Structures & Improvements Pumping	3,581	(83,586)
10		304500	3.99%	Structures & Improvements General	26,113	(704)
11		304700	3.99%	Structures & Improvements Store,Shop,Gge	4,629	(17,912)
12		304800	3.99%	Structures & Improvements Miscellaneous	(8,633)	(133,751)
13		311300	4.39%	Pumping Equipment Diesel	190	(62,413)
14		331001	1.53%	TD Mains Not Classified by Size	3,734,244	(2,735,897)
15		339600	3.31%	Other P/E-CPS	179,033	(573,526)
16		340330	25.00%	Computer Software Other	(6,528)	(9,129)
17		340500	7.13%	Other Office Equipment	321	(14,473)
18		345000	4.64%	Power Operated Equipment	32,228	(43,446)
19				**Sub-Total for Paradise Valley**		**$ (4,152,121)**
20	Sun City Water	303200	0.00%	Land & Land Rights Supply	268,738	$ (60)
21		334200	2.51%	Meter Installations	660,094	(137,217)
22		339600	0.00%	Other P/E-CPS	174,117	(62,988)
23		340200	10.00%	Computer & Periphal Equipment	223,286	(833,278)
24		340500	7.13%	Other Office Equipment	3,854	(3,387)
25		344000	3.71%	Laboratory Equipment	107,428	(5,932)
26				**Sub-Total for Sun City**		**$ (1,042,862)**
27	Tubac Water	303500	0.00%	Land & Land Rights T&D	422	$ (117)
28		342000	3.59%	Stores Equipment	0	(1,760)
29				**Sub-Total for Tubac**		**$ (1,877)**
30	Mohave Wastewater	355400	5.00%	WW Pwr Gen Equip TDP	142,907	$ (14,910)
31		360000	2.00%	WW Collection Sewers Forced	5,385	(15,840)
32		380100	3.60%	WW TD Equip Sed Tanks/Acc	336,115	(371,356)
33		380600	5.00%	WW TD Equip Oth Disp	28,914	(1,235)
34		397000	5.10%	WW Misc Equipment	-	(9,824)
35				**Sub-Total for Mohave Wastewater**		**$ (413,165)**
36	AZ-Corporate	346190	10.00%	Remote Control & Instrument	15,197	$ (2,945)
37		347000	6.25%	Miscellaneous Equipment	407,199	(15,430)
38				**Sub-Total for Allocable AZ-Corporate**		**$ (18,375)**
39	GRAND TOTAL					$ (5,906,243)

Allocation Factors by District for AZ-Corporate Allocable Plant:

Mohave Water	9.80%	Tubac	0.37%
Paradise Valley	2.99%	Mohave Waste	0.88%
Sun City	14.26%		

Total Allocated to the 5-Districts 28.30%

EXHIBIT 3

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2015 AUG 12 P 4: 05

AZ CORP COMMISSI[illegible]
DOCKET CONTROL

BEFORE THE ARIZONA CORPORATION COMMISSION

ORIGINAL

Arizona Corporation Commission
DOCKETED
AUG 12 2015
DOCKETED BY

SUSAN BITTER SMITH
Chairman

BOB STUMP
Commissioner

BOB BURNS
Commissioner

DOUG LITTLE
Commissioner

TOM FORESE
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS ANTHEM/AGUA FRIA WASTEWATER DISTRICT, SUN CITY WASTEWATER DISTRICT, AND SUN CITY WEST WASTEWATER DISTRICT	DOCKET NOS. SW-01303A-09-0343 W-01303A-09-0343 **REQUEST PURSUANT TO A.R.S. § 40-252**

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

In Decision No. 74881 (the "Decision"), the Arizona Corporation Commission ("Commission") ordered EPCOR Water Arizona, Inc. ("EWAZ" or "Company") to file a rate case for all five of its wastewater districts on or before September 30, 2015. According to the Decision, the rate filing must "allow the parties to examine the information on a fully consolidated basis and on a separate wastewater system basis. A fully deconsolidated wastewater proposal, by system, shall also be included in the rate filing."

Since the filing of the Decision, the Company has worked diligently compiling, and with regard to full deconsolidation, creating, the information necessary for the three scenarios: (1) full consolidation; (2) full deconsolidation into seven wastewater districts (including consolidation of Northeast Agua Fria and Sun City West); and (3) the status quo, *i.e.*, keeping the five wastewater districts as they are today. This process has proven to be extremely complex, time consuming and expensive. During this timeframe, EWAZ has also learned, in part through its experiences in its most recent, on-going rate case, that it is critical that these scenarios, and the related accounting information, be accurate from the outset.

Rate case filings not only require balance sheet information but also require supporting plant and associated accumulated depreciation activity (additions, retirements, transfers, and depreciation). Since this information has not historically been maintained on an accounting basis that would enable a segregation of these transactions into the respective scenarios, additional efforts have been necessary to segregate the data. In addition, the period since the last rate case encompasses six years for all but one of the five districts. During this six-year period, the accounting records have been maintained on two separate accounting systems under two different corporations. American Water used Power Plant to account for plant transactions, while EWAZ uses Oracle Fixed Assets to maintain its plant accounting records. These programs, and the historical records, are unique, distinct and require reconciliation.

Historical test year expenses also require segregation into the sub-districts to enable a filing that will comply with the Commission's directives for full deconsolidation. In instances where direct charges (for example labor and production charges) are not available, allocation methodologies must be identified and evaluated for their reasonableness. This has involved detailed work to identify operational behaviors that could be used to develop appropriate allocators.

Customers, the Commission, and the Company will all benefit from a wastewater rate case/consolidation filing that is accurate and based on carefully studied,

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independently reviewed allocations of costs and investments. As demonstrated during the first phase of this consolidation/deconsolidation proceeding, customers will be very interested in the rate impacts of the various consolidation and deconsolidation scenarios and deserve the most up to date, accurate and timely analysis and data that the Company can provide.

With this perspective in mind, the Company respectfully requests that it be given an extension until April 29, 2016 to file its wastewater rate application. Not only will the proposed extension provide the Company with the time necessary to assure the quality and accuracy of its filing, but it will also allow for the use of a December 31, 2015 test year, providing the most current financial and accounting information necessary for all parties to effectively review the current cost to deliver wastewater service to customers.

I. Basis for the Request for Additional Time.

In a filing made in February of this year, EWAZ requested clarification on the intent of the Decision as it related to the required deconsolidation scenario(s). As a result of that filing, Commission Staff clarified that the Decision required that EWAZ divide the Agua Fria Wastewater District into three new districts. After creating those three new districts, the Decision also required EWAZ to take one of the newly-created districts—Northeast Agua Fria– and combine it with Sun City West Wastewater District. The deconsolidation scenario also required the division of the Mohave Wastewater District into two new districts.

As EWAZ has explained throughout this proceeding, neither it, nor its predecessors, has ever split the costs of the current wastewater districts into the smaller communities that is now required. Contrary to the arguments of some and as noted above, this is proving to be a very complex, detailed and time-intensive process, as the Company expected—particularly, when the Company's predecessor, American Water, created and/or held much of this information. This exercise is particularly difficult as it relates to

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the creation of "roll forwards" for this rate case. Roll forwards are the exercise in any rate case of making all necessary changes in plant and depreciation from the date of the last rate case until the end of the test year. This is always a very time-consuming and personnel-intensive process, which is made more complex in this case by the need to provide this information on a deconsolidated basis.

A. **<u>EPCOR Wants to Avoid the Accounting Issues that Arose in its Last Rate Case.</u>**

In the Company's most recent rate case, the Company experienced challenges using accounting records from both EPCOR's systems and the systems of its predecessor, American Water.[1] The Company experienced difficulties reconciling these records, which ultimately led to delays in the proceeding until the Company could provide the data in a format required by Commission Staff and RUCO.[2] These difficulties were outlined in great detail in a recent Recommended Opinion and Order ("ROO") issued August 7, 2015.[3] As noted in the ROO, these accounting issues led to confusion, which in turn led to difficulties in processing the Application.[4] As set forth in the ROO, EWAZ is on notice that these issues need to be rectified for all districts prior to filing its next rate application.

Given the multiple scenarios and complexities involved in the current consolidation and deconsolidation scenarios, the Company is concerned about the potential for similar confusion to arise in this new application. To avoid these issues, the Company plans to provide Commission Staff and RUCO with a preview of the Company's data and the multiple scenarios once they are completed. This will take time and additional pre-filing effort, but will be intended to result in a rate filing that meets the expectations of all interested parties and ultimately results in a more efficient proceeding.

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[1] Docket No. WS-01303A-14-0010.
[2] Procedural Order dated October 16, 2014.
[3] Recommended Opinion and Order dated August 7, 2015, Docket No. WS-01303A-14-0010, at 14-15.
[4] ROO at 14-15.

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If the Company is not able to allow for this initial pre-filing review, it is possible, if not likely, that the same delays that arose in the prior rate case will arise in this case. Based on the current progress, the Company does not believe that sufficient time exists prior to September 30, 2015 to complete this exercise.

B. EWAZ Has Required Additional Resources to Create the New Districts.

As noted above, EWAZ strongly believes that a key component of this case is the accuracy of the costs, and their allocation, for purposes of the deconsolidation scenarios. To assist in this task, the Company commissioned the assistance of Ernst & Young to deconstruct the Agua Fria and Mohave systems so that the rate base of each of the deconsolidated districts could be determined. Following the Motion for Clarification filed by EWAZ in February, the Company suspended work by Ernst & Young until it became clear what the Commission desired in relation to the deconsolidation scenarios. This suspension proved wise, as Ernst & Young was required to change its approach based on this clarification. However, this also meant that the work did not resume until late May when clarification from the Commission was received, which put the work behind the original schedule. In addition, the current tasks are proving to be more complex and challenging than originally expected.

II. A December 31, 2015 Test Year Should Be Used.

During this proceeding, customers, Commission Staff and RUCO have all indicated that a new test year (rather than combining multiple test years from prior cases) is needed to properly examine consolidation and deconsolidation. Typically, Commission Staff requires that rates be in effect for between six and 12 months before a rate case is filed so that a more accurate snapshot of the Company's revenues and expenses may be examined. As part of the initial consolidation proceeding, new rates went into effect January 1, 2015. New rates for the Mohave Wastewater District are likely to go into effect within the next month. Accordingly, as part of this extension request, the Company is also requesting the use of a December 31, 2015 test year as the most appropriate test year to use for purposes of its new rate case.

II. <u>The Company Continues to Support Full Consolidation.</u>

The Company continues to believe consolidation is the best long-term solution and that it will be even more important as it continues to face the ever increasing need to renew aging infrastructure work. A broad customer base is the most efficient way of ensuring safe, reliable, affordable, high-quality wastewater service for all of the Company's customers. Consolidation will allow the Company to be more efficient with operations and provide an even higher level of customer service. With the costs associated with replacing aging infrastructure distributed over a larger base of customers, the Company can make timelier infrastructure investments based on the needs of all systems. Currently, with multiple, small systems, the Company is often forced to prolong needed infrastructure replacements to avoid triggering a large rate spike that can result from even a relatively small investment that impacts only a small subset of the Company's customers. The disparity of the current rates among our various wastewater districts is the result of that uneven investment impact.

III. <u>Conclusion</u>.

For the reasons discussed above, the Company respectfully requests that the Commission extend the deadline to file its rate case until April 29, 2016, with a December 31, 2015 test year.

Respectfully submitted this 12th day of August, 2015.

LEWIS ROCA ROTHGERBER, LLP

By ______________________________
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