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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

DOUG LITTLE, INTERIM CHAIRMAN
BOB STUMP
BOB BURNS
TOM FORESE

IN THE MATTER OF THE APPLICATION OF SOUTHLAND UTILITIES COMPANY, INC. FOR AN INCREASE IN RATES

DOCKET NO. W-02062A-15-0224

COMMENTS TO STAFF'S REPLY

Southland Utilities Company, Inc. ("Company" or "Southland") hereby files its comments to Staff's Supplemental Report filed on December 22, 2015 ("Staff's Reply").

CIAC and Amortization

The current issue regarding CIAC stems from the controversy relating to historic arguments concerning the WIFA surcharge. When the WIFA surcharge policy was being developed, several companies argued that the WIFA surcharge should include the debt service reserve payment obligation demanded by WIFA. In contrast, Staff took the position that the debt reserve payments should <u>not</u> be included in the surcharge. At first, the Commission sided with Staff. Once WIFA became aware of the issue, WIFA urged the Commission to allow the reserve payments to be included in the surcharge. WIFA surcharges became more and more common place over time, and as suggested by companies and WIFA, a few years ago both Staff and the Commission adopted the policy position that the debt reserve should be included in the surcharge.

Unfortunately, Southland's prior rate case occurred before the policy about the WIFA surcharge was settled. In 2001, at the Open Meeting during its last rate case, Staff argued for the first time that it would not support plant becoming part of Southland's rate base unless the Company used its own money to add the plant. In other words, plant installed with debt funding would have the principal portion paid for with surcharge funds be considered CIAC. This was a very unusual position (to our knowledge a one-time proposal). Southland opposed the position of course, arguing that the rate-making treatment for the plant built with WIFA surcharge funds should be addressed in the next rate case, which is common Commission practice. Nevertheless, the Commission followed Staff's position. Thus, in this one case, the principal portion of loan payments for plant installed by a small water company using debt is deemed CIAC and not included in its rate base.

Southland believes the Commission should not perpetuate this condition. First and foremost, the Commission's current policy is to include the reserve fees in the WIFA surcharge, which is what Southland was arguing in its last rate case. Second, the Commission's current policy is to encourage small companies to increase their rate base. Third, the unique nature of how this CIAC is treated for installed plant causes undue tracking and reporting expense above the norm. Simply stated, there is no reason to subject this Company to such a condition on an ongoing basis when this Commission's policies are identical to what the Company was arguing back in 2011.

Here, Staff acknowledges this condition is unusual. In the reply, Staff writes "Staff agrees that this ordering language may be unique and suggest that some additional regulatory accounting might be required to identify and track the level of plant paid for with the WIFA surcharge funds." Staff's Reply at p. 2. It is important to note that at no point has Staff explained why perpetuating this policy for this one company makes sense.

In addition to whether this policy should continue to be applied to this sole Company, Staff and Southland also disagree on the amount CIAC that should apply in this case. Staff recommends $104,130 and Southland is proposing $63,415, a difference of $40,715. The Company believes only the principal portion of the loan payments for the plant installed with proceeds from the WIFA loan through the end of the test year should be considered CIAC. On the other hand, Staff believes that the same principal portion of the loan payments for the plant installed with WIFA loan proceeds through January 2016, when a Decision was originally expected, should be considered CAIC. Staff still has not provided support for how the recommended amount of $104,130 for WIFA related CIAC was calculated. Staff's reasoning for choosing this date per the Response is that "the language in that decision does not suggest that the directive was only to apply through the end of the Company's next test year." In truth, the decision is silent on the matter. Thus, the Commission should follow its normal practice and not consider the rate case treatment of post test-year CIAC related to WIFA funded plant. In addition, Staff used projections for the amount of loan payments for 2015 and 2016 (and the resulting CIAC from the principal portion) that were not correct due to continuing loan draws throughout 2015 resulting in changing loan payment amounts. Knowing Staff has not supported its projected WIFA CIAC amount, the Court should adopt the Company's position.

Staff points to its rate base Adjustment B to explain the $5,884 difference between the Company and Staff proposed accumulated amortization of CIAC to reflect amortization of the CIAC imputed in rate base Adjustment A. This statement implies that the total $5,884 is attributed to the $104,130 of additional CIAC resulting from the WIFA payments. If this is the case, none of that CIAC is old enough to be fully amortized. As detailed on Schedule 2 of the Company Response (November 24, 2015), the only CIAC that is no longer being amortized is the $72,721 resulting from a line extension in 1984. All other CIAC, including the CIAC attributed to the WIFA loan, is still in the process of being amortized. Staff used an incorrect fully amortized contribution amount of $78,605 in its calculation of CIAC amortization. As pointed out in its response to the original Staff Report, Southland also disagrees with the Staff determined depreciation rate and resulting CIAC amortization rate of 5.65%, as the Company amounts are much more detailed and precise. Southland proposes the non-fully amortized CIAC related to prior line extensions continue to be amortized at 2.00% per year and the WIFA related CIAC at 5.01%.

Finally, Southland is not attempting to "rescind or modify" the CIAC order in Decision No. 72429. Instead, Southland seeks to cease the surcharge in this rate case and stop the accumulation of surcharge funds that will result in future CIAC. Any rate treatment of the principal portion of WIFA loan payments after the 2014 test year should be determined in the next rate case consistent with common Commission practice.

Cash Flow Analysis

Staff points to page 24 of the application as the source of the debt service amount of $83,591. Southland agrees that this was the actual amount recognized for the test year 2014. However, as mentioned above, the Company continued to draw on the WIFA loan and payments were adjusted several times during the year. As of August 2015, the monthly payment amounts were finalized at $7,646 per month and will continue at that amount for the duration of the loan. As a result, $91,952 will be the WIFA debt service amount each year going forward. Additionally, the cash flow amount recommended in its original Staff report of $76,581 on JLK-7 is overstated and would actually be $68,580, $8,001 less. The Company proposed cash flow amount of $76,298 is reasonable and approximates the Staff recommended amount when the correct debt service amount is used.

Rate Design

To be clear, it is critical that the Company's proposed revenue and Staff's proposed revenue match. Admittedly, the Company had an error in the bill count calculations initially, which was corrected. After the correction, there was still a mismatch, but Staff explained that its proposed rates generated slightly more than the revenue requirement, which is why the Company questioned whether there was an issue with the billing determinants or bill count calculations. Once Staff explained why there was a slight difference, it was clear calculations made by Staff and Southland were indeed for all intents and purposes the same. The Company still urges the Court to adopt its rate design.

The Company agrees that the proposed rates for service line and meter installation charges set forth in the Engineering Report are correct and consistent with the Company's current and proposed rates. Meanwhile, the charges in Schedule JLK-4 are inconsistent with Staff's recommendations as reflected in the Engineering Report. Therefore, the Company's position, which is consistent with the Engineering Report, should be adopted.

Resolved Issues

Staff's Reply revised earlier positions and removes the BMP requirements and allows for the rates to go into effect during the next billing cycles. The Company agrees with these positions.

DATED this 15th day of January, 2016.

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Original and **13** copies filed this
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