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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
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COMMISSIONERS

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TOM FORESE
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IN THE MATTER OF THE APPLICATION OF SOUTHLAND UTILITIES COMPANY, INC. FOR AN INCREASE IN RATES	DOCKET NO. W-02062A-15-0224 **SOUTHLAND'S SURREPLY**

Southland Utilities Company, Inc. ("Company" or "Southland") hereby files its surreply addressing Staff's Second Supplemental Staff Report dated March 11, 2016. ("Staff's Third Report").

1.0 Response to Staff's Initial Observations

Staff makes two initial points. First, Staff's proposed revenue requirement of $372,336 and the Company's revenue requirement of $373,119 proposed initially are almost identical. This is true, but it is slightly misleading. This statement overlooks the fact that Southland revised its position to seek a revenue requirement of $376,476. The difference in proposed revenue based on Southland revised filing and Staff's recommendation is $3,357. These proposed revenue requirements are not virtually identical, yet they are very close.

Next, Staff states it is concerned about going outside the test year. Staff argues that it is "concerned that consideration of cost of service changes having their genesis far outside the initial test-year will be inconsistent with the test year cut off and rate issue synchronization goals." Staff's Third Report at p. 1. Staff then states that updating the WIFA loan funding requirement "could move the level of rate granted increase substantially …." *Id.* These statements are confusing, especially because Staff is the party arguing to project post-test year loan principal payments as CIAC, which is the central issue in this case.

2.0 Property Tax

Southland is indifferent on the issue of the property tax assessment ratio. In its response, the Company updated the ratio to 18.50% to match Staff, but would not be opposed to using 18.00% to set rates. This change would result in a reduction of $450 per year in proposed property tax expense from $16,650 to $16,200 annually.

3.0 Loan Payment

Staff verified with WIFA and agrees the current annual loan funding requirement is $91,752, but continues to maintain that the $83,593 in the original application is the proper amount to recognize in this case. Not recognizing this known amount that WIFA will withdraw every month will immediately put Southland behind $8,000 per year. This is unreasonable. The Company is entitled to have the initial revenue requirement set at a level that generates enough cash flow to pay the monthly WIFA loan obligation.

In addition, Staff stated it "believes that updating the WIFA loan funding could result in a revenue increase substantially higher than the $41,352" requested by Southland. The Company included the proper amount of debt service in its proposed amended rate design, so clearly this insinuation is incorrect.

Additionally, during its conversation with a WIFA representative, Staff discovered the interest rate was initially stated as 4.436% but later was reflected as 4.2%. The interest rate reflected on the annual reports is what was reflected on the original loan documents and amortization schedule from WIFA. Southland inquired to WIFA as to the historical application of interest rates since the loans inception, and discovered that any overpayment of interest occurred on the initial loan payment and was credited to the second loan payment. Since WIFA automatically withdraws money each month to service its loan, the Company has no control over the amount withdrawn or the interest rate used.

4.0 CIAC

As the Court's questions to Staff indicate, the issue here is whether the Court should use projections regarding CIAC from the end of the test year until this rate case is decided? The answer is no. The upcoming decision should expressly state that Company principal payments made to WIFA after the test year should be treated normally, not recognized as CIAC. To the Company's knowledge, Southland is the only Company ever to receive such treatment and Staff does not even recommend this approach anymore. Truthfully, the Company is perplexed as to why Staff wants to project this policy into the next year knowing that it has been rejected by the Commission and Staff itself no longer advocates for this condition. This CIAC condition was an aberration and should be put to rest, not perpetuated past the test year.

Not surprisingly, Staff's response to the Court's inquiry regarding its position did not directly answer the questions, and the response Staff did provide gives the wrong impression. In its response, Staff "notes that the Company included post-test year plant in its application (2015) addition so consideration of the 2015 WIFA loan payments appears to be consistent with including 2015 post-test year plant additions." This implies that the 2015 post-test year plant additions are linked to the project funded by the WIFA loan, which is not true.

However, the Company's 2015 plant additions are related to a well failure that needed over $50,000 in immediate repairs. *See* Attachment 1. The Company would have postponed its rate case six months so the plant could have been considered as rate base, but the Company was ordered to file its rate case with the 2014 year end, so that decision was out of "Southland's control.

When considering post-test year plant, Staff's policy is that the plant should be (1) used and useful within six months of the test year and (2) the cost must be known and measurable. Known and measurable changes are changes in a company's assets and operations that occur after the end of a test year but before rates are set, and that are shown to be reliable and certain. *See Utah Power & Light Co. v. Idaho Public Utils. Comm,* 102 Idaho 282, 284, 629 P.2d 678, 680 (1981).

Here, all of the post-test year plant invoices were dated no later than April 15, 2015. This is well within six months of the end of the test year. Staff verified and accepted the plant in its recommendations. Thus, this plant was rightfully included in rate base and it has nothing to do with the CIAC issue.

Another problem with the CIAC issue is that it has created an accounting nightmare. Tracking complications stemming from how the WIFA loan payments must be recorded on Southland's books prevent these amounts from naturally appearing in the CIAC account when the payment is made. This is due to the fact that the credit associated with the WIFA payment is to the cash account and not CIAC. Therefore, the CIAC associated with the WIFA loan cannot be recognized on the books of the utility and must be tracked separately off the books. This an additional cost to the Company to track these differences as well as increasing the occurrences of errors when transactions cannot be properly tracked on the books during the normal course of business.

In sum, without reason or justification, Staff wants to project the CIAC treatment into the post-test year simply because it lowers the Company's rate base. But to the Company's knowledge the Commission only followed this approach once and Staff no longer advocates this approach. Unfortunately, Southland was the test case and it has paid the price. But there is no reason for the Company to continue to receive this treatment in the post-test year period when no other utility is treated in this manner. The fact that the Company rightfully included some post-test year plant consistent with the well-known Commission policy should not be a springboard to continue the CIAC treatment. The upcoming decision should expressly state that Company principal payments made to WIFA after the test year should be treated normally, not recognized as CIAC.

DATED this 4th day of April, 2016.

MOYES SELLERS & HENDRICKS LTD.

Steve Wene

Original and **13** copies filed this
4th day of April, 2016, with:

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

Donnelly Herbert

ATTACHMENT 1

Steve Wene

From: Bonnie O'Connor <boconnor@southwesternutility.com>
Sent: Wednesday, February 25, 2015 4:09 PM
To: Steve Wene; Sonn S Ahlbrecht (sonncpa@cox.net)
Cc: Keith Dojaquez
Subject: RE: Southland rate case

Okay sounds good. Just so we are all aware this is an issue. Thanks

Regards,

Bonnie O'Connor

President
Southwestern Utility Management, Inc.
520-624-1460 (then press 7)
boconnor@southwesternutility.com

From: Steve Wene [mailto:swene@law-msh.com]
Sent: Wednesday, February 25, 2015 4:07 PM
To: Bonnie O'Connor; Sonn S Ahlbrecht (sonncpa@cox.net)
Cc: Keith Dojaquez
Subject: RE: Southland rate case

I think we can get it in the rate base.

From: Bonnie O'Connor [mailto:boconnor@southwesternutility.com]
Sent: Wednesday, February 25, 2015 4:06 PM
To: Steve Wene; Sonn S Ahlbrecht (sonncpa@cox.net)
Cc: Keith Dojaquez
Subject: RE: Southland rate case

No that makes sense Steve. I just want to get the plant into the rate case.

Regards,

Bonnie O'Connor

President
Southwestern Utility Management, Inc.
520-624-1460 (then press 7)
boconnor@southwesternutility.com

From: Steve Wene [mailto:swene@law-msh.com]
Sent: Wednesday, February 25, 2015 3:54 PM
To: Bonnie O'Connor; Sonn S Ahlbrecht (sonncpa@cox.net)
Cc: Keith Dojaquez
Subject: RE: Southland rate case

Hi Bonnie,

The order specifically requires a test year ending on December 31, 2014. However, I think we can include the costs you are referencing as post-test year plant since the costs are known and measurable. We can make a compelling argument that we would have postponed the test year to include this costs, but we could not do so due to the order. This should give us a very good argument for including the post-test year plant. We talk about it if you like.

From: Bonnie O'Connor [mailto:boconnor@southwesternutility.com]
Sent: Wednesday, February 25, 2015 3:40 PM
To: Steve Wene; Sonn S Ahlbrecht (sonncpa@cox.net)
Cc: Keith Dojaquez
Subject: Southland rate case

Steve,

We are wondering if we could maybe use the test year of June 2014 thru June of 2015 for Southland due to all the expenses incurred this year so far. We are having to fix a well by replacing the column pipe as it has moved and is a mess. This is about a $56K job. Maybe we should discuss our options.

Regards,

Bonnie O'Connor

President
Southwestern Utility Management, Inc.
520-624-1460 (then press 7)
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