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ARIZONA CORPORATION COMMISSION

2009 SEP 23 P 2:06

DATE: SEPTEMBER 23, 2009

DOCKET NO.: W-02113A-07-0551

ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

TO ALL PARTIES:

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

CHAPARRAL CITY WATER COMPANY, INC.
(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:

OCTOBER 2, 2009

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:

OCTOBER 8, 2009

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

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

KRISTIN K. MAYES - Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE APPLICATION OF
CHAPARRAL CITY WATER COMPANY, INC.,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE FAIR VALUE OF
ITS UTILITY PLANT AND PROPERTY AND
FOR INCREASES IN ITS RATES AND CHARGES
FOR UTILITY SERVICE BASED THEREON.

DOCKET NO. W-02113A-07-0551

DECISION NO. _____

OPINION AND ORDER

DATES OF HEARING: December 5, 2008 (Pre-Hearing); December 8, 9, and 10, 2008, and January 8 and 9, 2009.

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Teena Wolfe

APPEARANCES: Mr. Norman D. James and Mr. Jay L. Shapiro, FENNEMORE CRAIG, on behalf of Chaparral City Water Company;

Ms. Michelle L. Wood, Attorney, on behalf of the Residential Utility Consumer Office;

Ms. Robin Mitchell, Ms. Amanda Ho, and Mr. Wesley Van Cleve, Staff Attorneys, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

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1 **BY THE COMMISSION:**

2 **I. INTRODUCTION**

3 On September 26, 2007, Chaparral City Water Company, Inc. ("Company" or "CCWC") filed
4 with the Arizona Corporation Commission ("Commission") an application for a rate increase, based
5 on a test year ended December 31, 2006.

6 On October 26, 2007, the Commission's Utilities Division ("Staff") filed a letter stating that
7 the application was found sufficient and classifying the Applicant as a Class A utility.

8 On November 19, 2007, the Residential Utility Consumer Office ("RUCO") filed an
9 Application to Intervene.

10 By Rate Case Procedural Order issued November 30, 2007, a hearing was set on the
11 application to commence on July 8, 2008, associated procedural deadlines were set, and intervention
12 was granted to RUCO.

13 On December 19, 2007, the procedural schedule set by the initial Rate Case Procedural Order
14 was modified as requested by the Company, with the hearing set to commence on July 21, 2008.

15 On January 22, 2008, a Procedural Order was issued granting a January 3, 2008, motion by
16 Staff to suspend the timeclock in this proceeding, until the Commission's final order in Docket No.
17 W-02113A-04-0616, a pending matter in which the rates of Chaparral City Water Company, Inc.
18 were also being considered. The parties were ordered to continue to conduct discovery and case
19 preparation to the greatest extent possible during the duration of the continuance in order to minimize
20 any delay in implementation of new rates pursuant to this application.

21 By the Second Amended Rate Case Procedural Order issued on July 24, 2008, the hearing
22 was set to commence on December 8, 2008. The Second Amended Rate Case Procedural Order set
23 the deadline for intervenor direct testimony at September 30, 2008, and the deadline for intervenor
24 surrebuttal testimony at November 18, 2008.

25 On September 15, 2008, Pacific Life Insurance Company dba Eagle Mountain Golf Club
26 ("Pacific Life"), a commercial customer of CCWC, filed a Motion to Intervene, which was granted
27 by Procedural Order issued September 26, 2008.

28

1 On September 30, 2008, a Procedural Order Extending Filing Deadlines was issued,
2 extending the deadline for intervenor direct testimony to October 3, 2008, and extending the deadline
3 for intervenor surrebuttal testimony to November 20, 2008.

4 RUCO and Staff filed direct testimony on September 30, 2008, and October 3, 2008,
5 respectively.

6 On October 24, 2008, Staff filed a Notice of Filing of Meeting on Settlement, and on October
7 28, 2008, Staff filed a Corrected Notice of Filing of Meeting on Settlement.

8 On October 31, 2008, the Company filed its rebuttal testimony.

9 On November 12, 2008, Pacific Life filed a Notice of Appearance of Counsel, indicating a
10 change of counsel.

11 On November 21, 2008, Staff filed a Notice of Witness Substitution and Request for
12 Procedural Order. Staff requested that it be allowed to file substitute witness Mr. Parcell's surrebuttal
13 testimony on cost of capital on December 3, 2008, and requested a date certain of December 15,
14 2008, for Mr. Parcell's live testimony.

15 On November 24, 2008, the Company filed its Response objecting to Staff's November 21,
16 2008 filing, and on November 26, 2008, Staff filed a Reply to the Company.

17 On December 2, 2008, a Procedural Order was issued granting Staff's request to file the
18 surrebuttal testimony of its substitute witness on December 3, 2008, and indicating that the dates
19 certain requested by Staff for presentation of its expert witness were not available for hearing, but
20 that a suitable schedule for proceeding with the parties' presentation of their cases on cost of capital
21 would be discussed at the prehearing conference scheduled for December 5, 2008.

22 The prehearing conference was held as scheduled. The Company, RUCO and Staff appeared
23 through counsel. Pacific Life did not enter an appearance. The Company stated an objection to
24 Staff's substitute witness Parcell's prefiled surrebuttal testimony, and the objection was discussed.
25 Staff agreed to make a filing regarding Mr. Parcell's adoption of Staff witness Mr. Chaves'
26 testimony. A date for Mr. Parcell to appear for cross-examination was discussed, but not determined,
27 during the prehearing conference.

28 On December 8, 2008, the hearing convened as scheduled and public comment was taken.

1 The Company, RUCO and Staff appeared through counsel, presented evidence and cross-examined
2 witnesses on all issues with the exception of cost of capital and rate of return. Pacific Life did not
3 appear. The hearing was recessed on December 10, 2008, and reconvened on January 8, 2009, for
4 the purpose of taking evidence on the bifurcated issues of cost of capital and rate of return. The
5 hearing concluded on January 9, 2009.

6 The parties subsequently submitted closing and reply briefs which were bifurcated in the same
7 manner as the hearing, with the final round of reply briefs filed on February 27, 2009.

8 In its reply brief on the issue of cost of capital, Staff requested that in light of the Company's
9 restating of arguments regarding the methodologies employed in Decision No. 70441, in order to
10 have a complete record in this case, that either Staff's testimony in the proceeding leading to
11 Decision No. 70441 ("Remand Proceeding") be admitted as a late-filed exhibit, or that administrative
12 notice be taken of the complete record of Docket No. W-02113A-04-0616. Due to the continuing
13 litigation on the issue of an appropriate fair value rate of return ("FVROR") methodology,
14 administrative notice is taken of the complete record of Docket No. W-02113A-04-0616.

15 On February 18, 2009, Staff docketed an update to its February 10, 2009, Motion to Compel.¹
16 Staff indicated that Staff and the Company had agreed to extend the time period in which the
17 Company has to respond, pending the outcome of ongoing negotiations to resolve the Motion to
18 Compel.

19 On March 4, 2009, the Company filed a Notice of Filing Late-Filed Exhibit. The exhibit
20 attached thereto is a rate case itemization spreadsheet showing a total for January 2007 - December
21 2008.

22 On June 3, 2009, a Procedural Order was issued directing Staff to file, by June 12, 2009, an
23 update regarding its Motion to Compel and the progress made in its discovery regarding the CPUC
24 investigation. The Procedural Order further directed that the update include a recommendation
25 regarding an appropriate procedural means of addressing the CPUC investigation issue, including

26 ¹ The Motion to Compel is related to an ongoing investigation by Staff. On January 5, 2009, Staff filed a Notice of Filing
27 Regarding Investigation. The Notice stated that the California Public Service Commission ("CPUC") had contacted Staff
28 regarding a CPUC investigation of Golden States Water Company ("Golden States"), an affiliate of CCWC. The CPUC
had alerted Staff that in the course of a CPUC investigation into Golden States, the CPUC had discovered information
relating to CCWC that it thought would be of interest to Staff.

1 whether it should be addressed in this docket, and directed the Company, Pacific Life and RUCO to
2 file responses.

3 On June 11, 2009, Staff filed a Request for Extension of Time, requesting that it be allowed to
4 file its update by June 19, 2009.

5 On June 12, 2009, the Company filed a Response in Opposition to Staff's Motion for
6 Extension of Time. Therein, the Company stated that it had offered to stipulate to either (1) keep this
7 docket open, pending conclusion of Staff's review of the CPUC investigation documents and a
8 determination of whether any further proceedings or relief are warranted, or (2) to open a new docket
9 for the same purpose, but that Staff had not definitively responded to the stipulation offer.

10 On June 17, 2009, RUCO filed a Response to Staff's Request for Extension of Time.

11 On June 17, 2009, a Procedural Order was issued granting Staff a one-week time extension,
12 and extending the time for filing responses thereto.

13 On June 19, 2009, Staff filed its Update and Reply to Chaparral City Water Company's
14 Response. Staff stated that ultimately, Staff and the Company had resolved their discovery dispute
15 through the execution of a protective agreement, upon which the Company provided Staff with over
16 15,000 pages of documents. Staff stated that its investigation is ongoing, and that Staff had not yet
17 determined whether the Company's activities rise to the level of impropriety or wrongdoing or
18 impact the Company's rates or this pending rate case. Staff stated that it had retained an outside
19 consultant to assist in Staff's review of the documents and to determine whether any alleged
20 improprieties have impacts for this rate case. Staff stated that it found the Company's stipulation
21 proposal acceptable, as long as all parties acknowledge that rates could be modified if the
22 investigation yields circumstances which would warrant such action.

23 On June 23, 2009, RUCO filed its Response to Staff's Update Regarding the CPUC
24 Investigation. RUCO agreed with Staff that there had been insufficient time to review and analyze
25 the documentation which the Company produced on March 10, 13 and 16, 2009. RUCO stated that it
26 did not object to having this matter proceed, but with the docket remaining open subject to
27 reconsideration in the event that the investigation by Staff, RUCO, or the CPUC reflects impropriety
28 by Chaparral or its parent, officers or employees.

1 On June 25, 2009, the Company filed a Response to Staff's Update. The Company asserted
 2 that there is no reason to delay rate relief, and requested the issuance of a decision in this matter as
 3 soon as possible.

4 This matter was subsequently taken under advisement, and a Recommended Opinion and
 5 Order was submitted for the Commission's consideration.

6 **II. APPLICATION**

7 CCWC, a California corporation in good standing in Arizona, is an Arizona public service
 8 corporation that holds a Certificate of Convenience and Necessity ("CC&N") authorizing it to
 9 provide water utility service within a service territory that is located in the northeastern portion of the
 10 Phoenix metropolitan area, in the Town of Fountain Hills and in a small portion of the City of
 11 Scottsdale.² During the test year, CCWC served 13,333 customers, including 12,431 residential, 375
 12 commercial and 442 irrigation customers.³ CCWC is in compliance with all federal, state, county
 13 and Commission requirements.⁴

14 On September 26, 2007, CCWC filed this rate increase application with the Commission
 15 based on a test year ended December 31, 2006. CCWC is currently charging rates approved in
 16 Decision No. 68176 (September 30, 2005), as modified by Decision No. 70441 (July 28, 2008), based
 17 on a test year ending December 31, 2003. The Company is requesting a gross revenue increase of
 18 \$2,852,353, which is an increase of 38.01 percent over test year revenues of \$7,505,010.⁵ The
 19 Company's requested revenues are based on its proposed rate of return of 9.96 percent on a fair value
 20 rate base ("FVRB") of \$27,751,113. The Company's FVRB is derived from a 50/50 weighting of an
 21 Original Cost Rate Base ("OCRB") of \$22,647,882, and a Reconstruction Cost New Rate Base
 22 ("RCND") of \$32,854,345. The Company proposes adjusted test year revenues of \$7,505,010 and
 23 test year operating expenses of \$7,646,730.

24 ...

25 ...

26 ² Direct Testimony of Company witness Robert N. Hanford (Exh. A-1) at 3-5.

27 ³ Direct Testimony of Company witness Thomas J. Bourassa (Exh. A-3), Schedule H-2 at 1.

28 ⁴ Direct Testimony of Staff witness Marlin Scott, Jr. (Exh. S-1) at 5-6.

⁵ These figures are from the Company's Amended Final Schedule A-1. The Application originally sought a \$3,063,400 increase in its revenue requirement, an increase of 41.14 percent over test year revenues.

1 **III. RATE BASE ISSUES**

2 **A. Treatment of the FHSD Settlement Proceeds**

3 The Fountain Hills Sanitary District ("FHSD") provides wastewater collection and treatment
 4 for most of CCWC's service area. FHSD needed to construct an Aquifer Storage and Recovery
 5 ("ASR") well in the vicinity of the Company's Well No. 9.⁶ While CCWC's primary water supply is
 6 imported Colorado River water, which is delivered by means of the Central Arizona Project
 7 ("CAP"),⁷ the Company blended CAP water with water from its Well No. 9 and two other wells.⁸
 8 The Company and FHSD entered into negotiations on a well exchange agreement, under which
 9 FHSD would supply CCWC with a new well similar in production and water quality to Well No. 9.⁹
 10 FHSD was unable to drill a well that yielded results satisfactory to the Company, and in January
 11 2005, the parties entered a Well Transfer Agreement under which FHSD paid CCWC \$1.52 million
 12 in consideration for CCWC ceasing use of Well No. 9 and Well No. 8 (a non-potable well), and
 13 CCWC giving FHSD an option to purchase the real property on which Well No. 8 is located.¹⁰

14 The Company proposes to treat the proceeds of the settlement in a manner that shares the
 15 benefit equally between ratepayers and shareholders.¹¹ The Company relied on the Commission's
 16 treatment of the Pinal Creek Group Settlement ("PCG Settlement") issue in Decision No. 66849
 17 (March 19, 2004) as a guide for its proposal in this case.¹² CCWC contends that it acted in the public
 18 interest by protecting its interests and those of its ratepayers by turning two aged wells, one of which
 19 was never in service, into cash and seeking to share those proceeds with its ratepayers.¹³ At the
 20 hearing, Staff's witness stated that for policy reasons, Staff agrees with the Company that the
 21 settlement proceeds should be shared equally between the shareholders and ratepayers so long as the
 22 Company shares the proceeds equally with the ratepayers in the event the wells are sold.¹⁴ The

23 _____
 24 ⁶ Direct Testimony of Company witness Robert N. Hanford (Exh. A-1) at 10; Tr. at 118.

25 ⁷ *Id.* at 3-5.

26 ⁸ *Id.* at 3; Tr. at 101.

27 ⁹ *Id.* at 10.

28 ¹⁰ *Id.*

¹¹ *Id.* at 10-11; Rebuttal Testimony of Company witness Thomas J. Bourassa (Exh. A-5) at 13-15; Rebuttal Testimony of Company witness Robert N. Hanford (Exh. A-2) at 1-4.

¹² Company Brief at 7; Company Reply Brief at 9. The PCG Settlement is discussed at pp. 32-37 of Decision No. 66849.

¹³ Company Reply Brief at 9.

¹⁴ Tr. at 351-52.

1 Company is willing share the gain with ratepayers in the event the wells are ever sold.¹⁵

2 RUCO disagrees with the Company's proposal, and recommends that the Company be
 3 required to distribute the \$1.52 million settlement proceeds to ratepayers minus the associated legal
 4 fees.¹⁶ While the Company argues that disallowing the sharing of the FHSD proceeds would serve as
 5 a disincentive to utilities to pursue litigation or settlement to protect assets,¹⁷ RUCO responds that in
 6 some cases, sharing of settlement proceeds may be appropriate, and that it does not object to the
 7 Company recovering its legal expenses associated with the settlement in this case.¹⁸ RUCO disagrees
 8 with Staff's position on this issue, contends that Staff's change in recommendation for policy reasons
 9 during the hearing is not supported by testimony or evidence,¹⁹ and argues that the prefiled testimony
 10 of Staff's witness, entered into the record prior to Staff's changed position on the issue at the hearing,
 11 supports its position.²⁰ RUCO asserts that the FHSD settlement proceeds should be allocated 100
 12 percent to CCWC's ratepayers because Well No. 8 and Well No. 9 were constructed over 36 years
 13 ago, have been fully depreciated, and have no impact on rate base in this case.²¹ RUCO contends that
 14 the Company has fully recovered the cost of the wells and received a reasonable return thereon, and
 15 therefore is not entitled to any of the settlement proceeds.²² RUCO argues that 100 percent of the
 16 settlement proceeds should go to ratepayers, because, according to RUCO, the FHSD settlement
 17 proceeds compensate CCWC for an equivalent cost of water to replace the amount Well No. 9 would
 18 have produced over the remainder of its useful life, and RUCO believes ratepayers will have to pay
 19 100 percent of the cost of replacement water.²³ RUCO contends that this FHSD issue is
 20 distinguishable from the PCG Settlement issue, because "there is no evidence in Decision No. 66849
 21 that the Company fully recuperated its investment of and on the contaminated wells."²⁴ RUCO also
 22 contends that this FHSD issue is distinguishable from the PCG Settlement issue, because Arizona

23 ¹⁵ Rebuttal Testimony of Company witness Robert N. Hanford (Exh. A-2) at 3-4; Tr. at 352-53.

24 ¹⁶ RUCO Brief at 9.

¹⁷ Company Brief at 10.

25 ¹⁸ RUCO Brief at 9.

¹⁹ RUCO Reply Brief at 10-11.

26 ²⁰ RUCO Brief at 10; RUCO Reply Brief at 8-9, citing Tr. at 416-17 and Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 13

27 ²¹ RUCO Brief at 8; Exh. R-10 (Company Response to Staff Data Request MEM 7.3).

²² RUCO Brief at 8.

28 ²³ *Id.*

²⁴ *Id.* at 9.

1 Water received replacement water and wells in that case.²⁵

2 While Decision No. 66849 did not find that the wells in question in that case were fully
3 depreciated, neither did it find that they were not fully depreciated. The determination on the sharing
4 of the PCG Settlement proceeds in Decision No. 66849 was based on a consideration of the PCG
5 Settlement in its entirety.²⁶ Decision No. 66849 allowed more than \$308,000 in legal expenses
6 associated with the PCG litigation, whereas here, the Company is not requesting recognition of its
7 legal expenses associated with the FHSD settlement proceeds.²⁷ Decision No. 66849 addressed the
8 present value of the replacement water provision of the PCG Settlement,²⁸ but specifically noted that
9 the replacement water provision of benefitted both ratepayers and the Company by providing
10 ratepayers with the benefit of future quantities of water and the Company with securing an assured
11 supply of water, eliminating the risk to the Company of obtaining additional supplies.²⁹ RUCO
12 attempts to argue in this case that the entire \$1.52 million of the FHSD settlement proceeds
13 compensates CCWC for an equivalent cost of water to replace the amount Well No. 9 would have
14 produced over the remainder of its useful life,³⁰ but has not called into question Mr. Hanford's
15 testimony that replacement water was not the only subject of the settlement reached by the parties.
16 The cost of replacement water, if any, has not been quantified in this case. While there may be
17 expense associated with obtaining replacement water for Well No. 9, if necessary, the Company bears
18 the risk of that endeavor. We find that by negotiating the FHSD settlement, the Company acted in
19 the interests of both the utility and the ratepayers in order to protect its assets, and we do not believe
20 such action should not be discouraged. The Company is not requesting allowance of the legal
21 expenses associated with the FHSD settlement, and has stated that if it sells Well No. 8 or Well No.
22 9, it will share the gain on such a sale with ratepayers. Under the circumstances of this case, the
23 sharing of the FHSD settlement proceeds equally between the Company and the ratepayers strikes an
24 equitable balance between encouraging the Company to pursue legitimate legal remedies, while

25 _____
26 ²⁵ Decision No. 66849 at 34.

27 ²⁶ *Id.* at 35.

28 ²⁷ *Id.*

29 ²⁸ *Id.* at 34.

30 ²⁹ *Id.*

31 ³⁰ RUCO Brief at 8.

1 preventing the Company from attaining a windfall at ratepayer expense. We therefore adopt the
2 treatment recommended by Staff and the Company. We will require the Company to notify the
3 Commission within thirty days of a sale of Well No. 8 or Well No. 9 by means of a filing in this
4 docket setting forth the terms of such sale, and to include the sharing of the gain on such a sale with
5 the ratepayers in the next rate filing subsequent to the sale.

6 **B. Treatment of the Additional CAP Water Allocation Acquisition Cost**

7 At the end of the test year, the Company had a CAP water allocation allowing it to take up to
8 6,978 acre-feet of Colorado River water annually.³¹ Under that contract, the Company also has the
9 right to buy excess CAP water,³² and has exercised that right in each of the last two years.³³ As a
10 result of the Arizona Water Settlement Act of 2004, CCWC had an opportunity to purchase an
11 additional CAP allocation of 1,931 acre-feet per year.³⁴ CCWC states that when presented with the
12 opportunity, it considered the unavailability of additional CAP water and other renewable water
13 supplies, and paid \$1.28 million for the additional CAP allocation in December, 2007.³⁵ As with its
14 first CAP allocation, its contract for the additional CAP allocation requires the Company to pay
15 annual Municipal and Industrial ("M&I") capital charges based on the size of the additional CAP
16 allocation, and to pay purchased water charges based on annual water use.³⁶

17 Parties' Positions

18 CCWC states that it acquired the additional CAP allocation to ensure its long-term water
19 supply, including an increase to its drought buffer from both intrastate and interstate demand for
20 Colorado River water supply,³⁷ and to reinforce and continue its reliance on renewable water
21 supplies.³⁸ CCWC contends that full cost recovery is warranted because the additional CAP
22 allocation was offered only in a fixed amount and was a one-time only opportunity at a fixed price.³⁹
23 CCWC contends that the Colorado River is already overcommitted as a water source, and future

24 ³¹ Direct Testimony of Staff Witness Marlin Scott, Jr. (Exh. S-1), Engineering Report at 11.

25 ³² Tr. at 140-141.

26 ³³ Company Brief at 10, fn 36 and Exhibit 1.

27 ³⁴ Direct Testimony of Company witness Robert N. Hanford (Exh. A-1) at 5.

28 ³⁵ Company Brief at 10.

³⁶ Direct Testimony of Company witness Thomas J. Bourassa (Exh. A-3) at 16 and Schedule C-2, page 6.

³⁷ Rebuttal Testimony of Company witness Robert N. Hanford (Exh. A-2) at 6.

³⁸ Direct Testimony of Company witness Robert N. Hanford (Exh. A-1) at 5-7.

³⁹ Company Brief at 11.

1 reductions in CAP water deliveries are a real possibility.⁴⁰ CCWC asserts that it must plan for its
2 water supply needs not only for the next year, but for the next several decades and longer.⁴¹ CCWC
3 believes that the acquisition of the additional CAP allocation should be viewed as an “indivisible
4 whole” that produces benefits to the ratepayers that could not have been obtained had the Company
5 not paid the \$1.28 million acquisition price, and that the entire acquisition cost is therefore used and
6 useful.⁴²

7 Staff is in agreement with the Company that the entire acquisition cost of the additional CAP
8 allocation should be included in rate base, classified as a plant-in-service component of Land and
9 Land Rights, and not subject to amortization.⁴³ In its Engineering Report on the application, Staff
10 found that approximately half the requested additional 1,931 acre-feet per year CAP allocation (966
11 acre-feet) would be used and useful within a five-year timeframe.⁴⁴ Based on that determination,
12 Staff is recommending that the Company be allowed recovery of 50 percent of the associated annual
13 M&I charges.⁴⁵ Staff contends that the full allocation should be included in rate base at this time,
14 however, because reallocation of CAP water occurs infrequently, and CAP water is oversubscribed.⁴⁶
15 Staff states that it is imperative to secure an additional CAP allotment when it becomes available, and
16 believes CCWC acted prudently in the \$1.28 million purchase of the additional CAP allocation,
17 based on the combination of two factors: the CAP reallocation opportunity was for all or nothing of a
18 fixed amount, and the additional CAP allocation will allow CCWC to limit or eliminate the use of
19 groundwater to serve its customers.⁴⁷

20 RUCO disagrees with the recommendations of the Company and Staff, and makes several
21 arguments against inclusion of the additional CAP allocation in rate base. RUCO argues that the
22 additional CAP allocation should not be put in rate base at all, because doing so would allow the

23 ⁴⁰ Company Brief at 12, citing Tr. at 131-133.

24 ⁴¹ *Id.*

24 ⁴² Company Brief at 12-13.

25 ⁴³ Staff Brief at 3, Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 15-18; Company Brief at 11.

25 ⁴⁴ Direct Testimony of Staff witness Marlin Scott, Jr. (Exh. S-1) at *ii*, and Engineering Report at 11.

26 ⁴⁵ Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 27-28. As discussed in the Operating Income
27 section below, the Company agrees with the operating expense treatment, and RUCO agrees that M&I expenses should be
27 allowed in an amount commensurate with the portion of the additional CAP allocation that is determined to be used and
27 useful.

28 ⁴⁶ Staff Brief at 3, citing Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 18.

28 ⁴⁷ *Id.*

1 Company to expand its service area as requested in Decision No. 68238 (October 25, 2005) for the
 2 benefit of the State Land Department or a developer at the expense of current ratepayers.⁴⁸ RUCO
 3 argues that if the Company needs a drought buffer, it should “work more diligently to resolve its
 4 long-standing water loss issue.”⁴⁹ RUCO contends that Staff’s growth projections are unreliable,⁵⁰
 5 and that the Company’s demand estimates do not support placing 100 percent of the additional CAP
 6 allocation in rate base.⁵¹ RUCO states that its witness’ accounting analysis opinion is that the current
 7 used and useful portion of the additional CAP allocation “is only about in the single digits.”⁵² RUCO
 8 recommends, however, that “[i]f the Commission determines that some measure of the additional
 9 CAP allocation is needed for a drought buffer . . . RUCO’s revised recommendation is that no more
 10 than 35% of the additional CAP allocation be treated as land and land rights in a non-depreciable
 11 account.”⁵³ RUCO’s arguments are addressed below.

12 Decision No. 68238 Order Preliminary

13 RUCO advances an argument that the additional CAP allocation should be totally excluded
 14 from rate base, because putting it in rate base “would allow the Company to expand its service area
 15 for the benefit of the State Land Department or a developer at the expense of current ratepayers.”⁵⁴
 16 RUCO is referring to Docket No. W-02113A-05-0178. On October 25, 2005, Decision No. 68238 in
 17 that docket granted CCWC an Order Preliminary for a Final Order granting an extension of CCWC’s
 18 CC&N to include approximately 1,300 acres of state trust land located north of the Town of Fountain
 19 Hills, immediately adjacent to the Company’s existing CC&N area.⁵⁵ The Staff Engineering Report
 20 in this case notes that one of the requirements Decision No. 68238, imposed for the issuance of a
 21 Final Order in that docket is for CCWC to demonstrate sufficient water source capacity for its water
 22 system.⁵⁶ RUCO charges that the additional CAP allocation at issue in this case is needed not for the

23 ⁴⁸ RUCO Reply Brief at 2.

24 ⁴⁹ *Id.* at 7.

25 ⁵⁰ *Id.* at 3-4.

26 ⁵¹ *Id.* at 5.

27 ⁵² *Id.* at 7, citing Tr. at 301-02.

28 ⁵³ *Id.* at 7.

⁵⁴ *Id.* at 2.

⁵⁵ Decision No. 70608 (November 12, 2008) extended the deadline for compliance with the Order Preliminary deadlines established in Decision No. 68238 to April 25, 2010.

⁵⁶ Direct Testimony of Staff Witness Marlin Scott, Jr. (Exh. S-1), Engineering Report at 11. Decision No. 68238 orders the following:

1 purpose of satisfying the demands of current customers, but instead to provide a 100-year assured
 2 water supply to permit the sale of the state trust land to a private subdivision developer.⁵⁷ RUCO
 3 argues that the Order Preliminary indicated that the Company had sufficient source and storage
 4 capacity to serve up to 18,000 customers,⁵⁸ and is concerned that ratepayers will bear the full cost of
 5 the additional CAP allocation “while the true beneficiaries, the subdivision developer and/or the
 6 State, receive the benefit.”⁵⁹

7 According to the Company, its request for inclusion of the additional CAP allocation
 8 acquisition costs in rate base was not based on benefiting a subdivision developer.⁶⁰ In response to
 9 RUCO’s argument regarding the Order Preliminary requirements, the Company states that in the
 10 event the property covered by the Order Preliminary is developed at some future date, current
 11 customers would actually benefit from the potential expansion, both from the increase of the
 12 customer base over which the Company recovers its cost of service, and from the collection of hook-
 13 up fees from new customers.⁶¹ Staff’s witness testified that the Order Preliminary’s requirement that
 14 the Company demonstrate an adequate water supply in order to receive a Final Order was only one
 15 item Staff considered in looking at whether the Company’s acquisition of the additional CAP
 16 allocation was prudent.⁶² The witness emphasized that Staff’s main consideration in its prudence
 17 analysis was ADWR’s requirement that the acquisition be an all or nothing purchase.⁶³

18 RUCO did not raise this issue in its prefiled testimony in this case, and therefore the factual
 19 record on the issue is limited. As stated above, Decision No. 68238 is an Order Preliminary, and not
 20

21 “IT IS FURTHER ORDERED that, prior to issuance of a Final Order, Chaparral City Water Company,
 22 Inc. shall be required to demonstrate to the satisfaction of the Commission’s Director of Utilities that
 23 the Company is able to meet the water production needs for its system, PWS No. 07-017, for both its
 24 current customer base as well as expected demand for the proposed extension area. Sufficient capacity
 25 may be demonstrated by filing with Docket control a list of pending or future water sources, their
 26 anticipated production capacity in gallons per minute, and a time schedule for ADEQ approval of
 27 construction and operation.”

28 Decision No. 68238 at 8.

⁵⁷ RUCO Reply Brief at 1-2, citing Decision No. 68238 at 3, fn 2.

⁵⁸ RUCO Reply Brief at 1. Decision No. 68238 states that “Staff indicated that Chaparral City currently has sufficient
 source and storage capacity to serve up to 18,000 customers.” Decision No. 68238 at 3, Findings of Fact No. 6.

⁵⁹ RUCO Reply Brief at 3.

⁶⁰ Company Reply Brief at 13-1; *see also* Direct Testimony of Company witness Robert N. Hanford (Exh. A-1) at 5-7;
 Company Brief at 12, citing Tr. at 131-133.

⁶¹ Company Reply Brief at 14.

⁶² Tr. at 337.

⁶³ *Id.*

1 a Final Order. No request for a Final Order has yet been filed, and it therefore remains to be seen
 2 whether a Final Order will be considered in Docket No. W-02113A-05-0178. It is therefore
 3 inappropriate to base a determination on whether to allow rate base recovery of the additional CAP
 4 allocation acquisition cost on the existence of that docket. We agree with the Company that
 5 regardless of the outcome in Docket No. W-02113A-05-0178, all its customers will benefit from the
 6 additional CAP allocation.

7 Unaccounted-for Water

8 While RUCO recommends inclusion of 35 percent of the additional CAP allocation in rate
 9 base as a drought buffer if needed, RUCO simultaneously argues that if the Company needs a drought
 10 buffer, it should “work more diligently to resolve its long-standing water loss issue.”⁶⁴ RUCO states
 11 that in 2007, the Company reported unaccounted-for water of 1,030 acre-feet, or 14 percent⁶⁵ as a
 12 result of metering inaccuracies either at the homes of ratepayers or at the CAP canal.⁶⁶ RUCO does
 13 not agree with Staff the fact that the Company’s current CAP allocation was exceeded in 2006 shows
 14 a need for the additional CAP allocation.⁶⁷ RUCO argues that “if the Company accounted for the
 15 water in excess of the acceptable loss standard (10%), the Company would have an additional 4% or
 16 315.5-plus acre-feet available to satisfy the needs of its customers” and “[i]f the Company accounted
 17 for unaccounted water there would be no need for additional CAP allocation for drought buffer.”⁶⁸
 18 RUCO’s position fails to take into account that, as RUCO acknowledges,⁶⁹ the Company’s test year
 19 unaccounted-for water was not due to “water loss,” i.e., leaks, broken mains or maintenance issues.
 20 The non-account water issue is likely to be the result of a faulty CAP meter, an issue that the
 21 Company is working to resolve with the Central Arizona Water Control District.⁷⁰ Staff’s
 22 engineering witness testified that CCWC is well-operated, well-maintained and well-managed, and
 23 that CCWC is not ignoring water loss issues.⁷¹ As the Company points out, resolution of the likely

24 ⁶⁴ RUCO Reply Brief at 7.

25 ⁶⁵ RUCO Brief at 5, citing to Tr. at 62.

26 ⁶⁶ *Id.* at 5-6, citing to Tr. at 67, 320.

27 ⁶⁷ RUCO Reply Brief at 6, referring to Direct Testimony of Staff witness Marlin Scott, Jr. (Exh. S-1), Engineering Report
 at 11.

28 ⁶⁸ RUCO Reply Brief at 6.

⁶⁹ RUCO Brief at 5-6.

⁷⁰ Tr. at 38, 127-131.

⁷¹ Tr. at 312, 319.

1 cause of the unaccounted-for water, a faulty CAP meter, will not result in any additional wet water
2 for the Company to serve its customers.⁷² We agree with the Company on this point, and find that
3 RUCO's arguments regarding unaccounted-for water do not justify excluding the additional CAP
4 allocation from rate base.

5 Staff's Engineering witness states that the Company is aware of its 15.9 percent unaccounted-
6 for water/water loss amount, and that the Company informed Staff it will be installing its own CAP
7 water meter at its Shea Water Treatment Plant to determine whether the CAP intake meter is
8 accurately registering.⁷³ Staff recommends that the Company begin a 12-month monitoring exercise
9 of its water system after the Company completes its own CAP water meter installation.⁷⁴ Staff
10 further recommends that the Company docket the results of the system monitoring as a compliance
11 item in this case by March 1, 2010.⁷⁵ Staff recommends that if the reported water loss for the period
12 from February 1, 2009 through February 1, 2010 is greater than 10 percent, the Company be required
13 to prepare a report containing a detailed analysis and plan to reduce water loss to 10 percent or less,
14 or alternatively, if the Company believes it is not cost effective to reduce water loss to less than 10
15 percent, the Company should be required to submit a detailed cost benefit analysis to support its
16 opinion.⁷⁶ Staff recommends that the Company be required to docket the report or alternative cost
17 benefit analysis, if required, by April 30, 2010, as a compliance item for this proceeding for review
18 and certification by Staff, and that in no case should water loss be allowed to remain at 15 percent or
19 greater.⁷⁷ Staff's recommendations on this issue are reasonable and will be adopted.

20 Need for the Additional CAP Allocation

21 RUCO contends that CCWC's current water supplies, without the additional CAP allocation,
22 are sufficient to meet the Company's its current and future demand.⁷⁸ At the same time, RUCO
23 argues that if it is determined that some measure of the additional CAP allocation is needed to
24 provide a drought buffer in the event of future curtailments of CAP water, only the used and useful

25 ⁷² Company Reply Brief at 13, citing Tr. at 130-31.

26 ⁷³ Direct Testimony of Staff Witness Marlin Scott, Jr. (Exh. S-1) at *i*.

27 ⁷⁴ Direct Testimony of Staff Witness Marlin Scott, Jr. (Exh. S-1) at *i*.

28 ⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ RUCO Reply Brief at 7.

1 portion of the additional CAP allocation should be included in rate base,⁷⁹ and that a current absence
 2 of growth in CCWC's service area and CCWC's unaccounted-for water should be considered in
 3 determining the amount of the additional CAP allocation that is used and useful.⁸⁰ RUCO
 4 recommends that "no more than 35%" of the additional CAP allocation be treated as Staff and the
 5 Company propose.⁸¹ RUCO contends that the Company's demand estimates do not support placing
 6 100 percent of the additional CAP allocation in rate base,⁸² arguing on brief that "by Mr. Hanford's
 7 optimistic estimates, 18.17% of the additional CAP allocation will be needed by 2010 and 31.43% by
 8 2016."⁸³ RUCO also expresses disagreement with Staff's projections, arguing that the growth
 9 projections Staff relied on in its determination that 50 percent of the additional CAP allocation is
 10 used and useful do not consider current economic circumstances in the Company's service territory.⁸⁴
 11 RUCO argues that to reach Staff's projections, CCWC would have to establish 334 new accounts per
 12 year from 2007 through 2012,⁸⁵ but provided no alternative growth projections or evidence to
 13 support its claim other than the accounting analysis opinion of RUCO's witness that the current used
 14 and useful portion of the additional CAP allocation "is only about in the single digits."⁸⁶ RUCO's
 15 recommendation on this issue that "no more than 35 percent" of the additional CAP allocation should
 16 be allowed in rate base is difficult to reconcile with its arguments.

17 The Company states that if it is denied recovery for the additional CAP allocation, the
 18 Company would receive a message that it should rely on groundwater pumping if shortages occur,
 19 instead of looking out for the long-term interests of its customers and the community of Fountain
 20 Hills by obtaining additional CAP water supplies.⁸⁷ RUCO argues that since the Company intends to
 21 file a rate case again in two to three years,⁸⁸ it is not imperative to include 100 percent of the
 22 additional CAP allocation in rate base.⁸⁹ The Company explains that if it is not accorded reasonable

23 ⁷⁹ *Id.*

24 ⁸⁰ *Id.*

24 ⁸¹ *Id.*

25 ⁸² *Id.* at 5.

25 ⁸³ *Id.*, citing Tr. at 83-84.

26 ⁸⁴ RUCO Reply Brief at 3-4.

26 ⁸⁵ *Id.* at 4, referring to Direct Testimony of Staff Witness Marlin Scott, Jr. (Exh. S-1), Engineering Report at 5.

27 ⁸⁶ *Id.* at 7, citing Tr. at 301-02.

27 ⁸⁷ Rebuttal Testimony of Company witness Robert J. Sprowls (Exh. A-8) at 5.

28 ⁸⁸ RUCO Reply Brief at 6, citing Tr. at 121.

28 ⁸⁹ RUCO Reply Brief at 6.

1 cost recovery for its purchase of the additional CAP allocation, it is unlikely that it will be able to
2 keep the right that it believes it prudently acquired for the benefit of its customers.⁹⁰ The Company's
3 witnesses testified that the Company has made an investment and expects a return on the investment,
4 and that if full recovery of the acquisition costs is not allowed, the Company will be faced with a
5 choice of how to otherwise recoup its investment.⁹¹ If denied regulatory recovery of the investment
6 made on behalf of its ratepayers, according to the Company, its choices will be to either: (1) retain
7 the additional allocation and look for entities who wish to enter into wholesale water delivery
8 arrangements from it; or (2) exchange or relinquish the additional acquisition and get its acquisition
9 payment back.⁹²

10 The application process for the available additional CAP allocations was a competitive one
11 that considered the applicants' needs under the Third Management Plan.⁹³ Of fifty-three applicants
12 seeking a portion of the 65,647 acre-feet of CAP water available for reallocation, only twenty-six
13 applicants were considered in the first round, and CCWC was one of twenty who were subsequently
14 given the opportunity to purchase an additional CAP allocation.⁹⁴ Based on the factual record in this
15 case, we agree with Staff's reasoned recommendation, agreed to by the Company, that the entire
16 acquisition cost of the additional CAP allocation be included in rate base, classified as a plant-in-
17 service component of Land and Land Rights, and not subject to amortization. Our determination is
18 based on the Company's need to provide its customers continued access to adequate renewable water
19 supplies, and on the fact that CCWC acted prudently under the circumstances in the December, 2007,
20 \$1.28 million purchase of the additional CAP allocation.

21 C. Working Capital

22 The Company did not prepare a lead/lag study to quantify its cash working capital
23 requirement.⁹⁵ Staff contends that in the absence of the cash working capital component of a lead/lag

24 ⁹⁰ Company Reply Brief at 12.

25 ⁹¹ Direct Testimony of Company witness Robert N. Hanford (Exh. A-1) at 7.

26 ⁹² Direct Testimony of Company witness Robert N. Hanford (Exh. A-1) at 7.

27 ⁹³ Direct Testimony of Staff witness Marlin Scott, Jr. (Exh. S-1), Engineering Report at 11; Tr. at 325-327.

28 ⁹⁴ *Id.*

⁹⁵ A company's working capital requirement represents the amount of cash the company must have on hand to cover any differences in the time period between when revenues are received and expenses must be paid. The most accurate way to measure the working capital requirement is via a lead/lag study. The lead/lag study measures the actual lead and lag days attributable to the individual revenue and expenses. Staff Brief at 4.

1 study, it is inappropriate to consider other components of working capital, and therefore disallowed
 2 prepayments and materials and supplies inventory from rate base.⁹⁶ Staff's proposed adjustment to
 3 rate base removes (1) Unamortized Debt Issuance Costs in the amount of \$424,010, (2) Prepayments
 4 in the amount of \$192,485, and (3) Materials and Supplies Inventory in the amount of \$14,521, for a
 5 total reduction to rate base of \$631,016.⁹⁷

6 The Company argues that there is no requirement that it prepare a lead/lag study, and that it
 7 adopted the lead/lag study prepared by RUCO, along with the negative working capital allowance
 8 RUCO derived from its study.⁹⁸ RUCO's recommended total working capital is \$95,400, which
 9 consists of a negative Cash Working Capital allowance of (\$111,606), Prepayments in the amount of
 10 \$192,485, and Materials and Supplies in the amount of \$14,521.⁹⁹ The Company is critical of the fact
 11 that Staff did not analyze RUCO's lead/lag study, which was presented in RUCO's direct testimony,
 12 and argues that because Staff did not challenge RUCO's lead/lag study, it should therefore be
 13 adopted in lieu of Staff's disallowances.¹⁰⁰ Staff responds that if the Company had prepared a
 14 lead/lag study and submitted it with its application, Staff would have had an opportunity to review it
 15 and make a recommendation on it.¹⁰¹

16 The Company correctly states that Unamortized Debt Issuance Costs are actually not a part of
 17 working capital.¹⁰² Staff's witness testified at the hearing that while they are not, they should be
 18 removed from rate base nonetheless, because they are a below-the-line expense, and similar to
 19 interest, are amortized over the life of the debt, and adds that it would also be improper to allow them
 20 as operating expenses.¹⁰³ The Company disagrees with Staff's assessment that the Unamortized Debt
 21 Issuance Costs are a below-the-line expense. The Company argues that no evidence was presented
 22 that the costs were improper or unreasonable, calls the idea "nonsensical,"¹⁰⁴ and argues that if
 23 Unamortized Debt Issuance Costs are removed from rate base, Staff should have included them in

24 ⁹⁶ Staff Brief at 5, citing Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 23.

25 ⁹⁷ Staff Brief at 5, citing Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 22.

26 ⁹⁸ Company Reply Brief at 1.

27 ⁹⁹ Direct Testimony of RUCO witness Timothy J. Coley (Exh. R-8) at 23-24.

28 ¹⁰⁰ Company Reply Brief at 1.

¹⁰¹ Staff Reply Brief at 2.

¹⁰² Company Reply Brief at 2.

¹⁰³ Tr. at 375-381.

¹⁰⁴ Company Brief at 2.

1 calculating the Company's cost of debt, but did not.¹⁰⁵ However, the Company provided no evidence
2 controverting Staff's expert accounting testimony that Unamortized Debt Issuance Costs should be
3 removed from rate base.¹⁰⁶

4 A lead/lag study is the most accurate and appropriate means of measuring the working capital
5 requirements of a utility of CCWC's size. The Company could have prepared and included with the
6 application a lead/lag study to support its request for recovery of working capital allowance. If it had,
7 all parties would have had adequate time for analysis and discovery related to the lead/lag study. The
8 Company chose not to do so. In the absence of the cash working capital component of a lead/lag
9 study, it is inappropriate to consider other components of working capital. The Company chose not
10 to provide a lead/lag study for analysis, but wishes the Commission to allow recovery of working
11 capital components nonetheless. The fact that a lead/lag study was presented by RUCO, and that
12 Staff did not challenge it, does not compel its adoption. Neither does the fact that a lead/lag study
13 was presented by RUCO compel the rejection of Staff's proposed adjustments. RUCO's accounting
14 witness testified that "[s]hould the Commission reject RUCO's first recommendation, RUCO's
15 second recommendation would be to disallow the Company the opportunity to recover materials &
16 supplies and prepayments for which it seeks recovery, since those two items are components of a
17 working capital allowance adjustment."¹⁰⁷ Staff's proposed disallowance of \$192,485 in
18 Prepayments and \$14,521 in Materials and Supplies Inventory is appropriate, and will be adopted. In
19 addition, the record supports removal of \$424,010 in Unamortized Debt Issuance Costs from rate
20 base. A total reduction to rate base of \$631,016 is reasonable and will be adopted.

21 Staff recommends that the Company be ordered to perform and submit a lead/lag study in
22 conjunction with its next rate adjustment request application in order to meet the sufficiency
23 requirements of that filing. There was no objection to that recommendation, which is reasonable and
24 will be adopted.

25 _____
26 ¹⁰⁵ Company Reply Brief at 14.

27 ¹⁰⁶ The Company may be correct that the Unamortized Debt Issuance Costs should have been included in calculating the
28 cost of debt, but if so, the Company also should have included them in its calculation. As discussed below, the parties are
in general agreement on the cost of debt, with the cost of debt adopted in this proceeding slightly higher than that
proposed by the Company.

¹⁰⁷ RUCO's Direct Testimony of RUCO witness Timothy J. Coley (Exh. R-8) at 24.

1 **D. CIAC Amortization Rate**

2 The Company and Staff agree regarding the method for amortization of Contributions in Aid
 3 of Construction (“CIAC”),¹⁰⁸ which includes computation of a composite CIAC amortization rate
 4 based on depreciation expense.¹⁰⁹ RUCO objects to the method, and recommends instead that the
 5 Company “be required to utilize the amortization rate established in the prior case or a rate
 6 established based on CIAC amounts and the corresponding plant depreciation rates to insure that
 7 plant and CIAC are properly matched.”¹¹⁰ Decision No. 68176 did not establish a specific CIAC
 8 amortization rate to be used on a going forward basis. The Company is correct that the reason
 9 specific CIAC amortization rates are not set on a going forward basis is that the amortization rate is
 10 expected to be adjusted to match the composite depreciation rate for each year, and using a fixed
 11 composite rate for amortization of CIAC over lengthy intervals between rate cases can result in
 12 significant mismatches between net plant-in-service and net CIAC.¹¹¹ Using the CIAC amortization
 13 rate utilized in that proceeding would not meet RUCO’s goal of insuring that plant and CIAC are
 14 properly matched, whereas the methodology used by the Company and Staff in this proceeding does.
 15 The methodology used by the Company and Staff, which is based on CIAC amounts, depreciable
 16 plant, and depreciation expense in this case, properly matches net plant-in-service and net CIAC, and
 17 will be adopted.

18 **E. Accumulated Depreciation**

19 Staff proposes an adjustment to reduce Accumulated Depreciation by \$2,031,950 from the
 20 Company’s amount of \$15,877,022 to reflect Staff’s Accumulated Depreciation of \$13,845,072.¹¹²
 21 Staff states that the reason for the difference is related to Staff’s use of the 4.0 percent General Office
 22 plant allocation factor and the plant additions and retirements of wells and other plant.¹¹³ Staff
 23 contends that the 4.0 percent allocation factor is more correctly matched to the test year.¹¹⁴ The
 24 Company agrees, and states that it accepted the 2.8 percent allocation factor proposed by RUCO as a

25 ¹⁰⁸ Company Reply Brief at 14.

26 ¹⁰⁹ Staff Reply Brief at 2-3.

26 ¹¹⁰ RUCO Reply Brief at 12.

27 ¹¹¹ Company Brief at 15.

27 ¹¹² Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 20.

28 ¹¹³ *Id.*

28 ¹¹⁴ *Id.*

1 compromise and to help minimize issues, even though it would result in a lower rate base and lower
 2 rates.¹¹⁵ RUCO did not address the issue on brief. Staff's adjustment is reasonable and will be
 3 adopted.

4 **IV. FAIR VALUE RATE BASE**

5 Based on the foregoing discussion, we adopt an adjusted OCRB for the Company of
 6 \$22,214,877, and an adjusted RCND of \$33,025,951, weighted 50/50, for a FVRB of \$27,620,414.

7 **V. OPERATING INCOME ISSUES**

8 **A. Property Tax Expense Calculation**

9 The Company and Staff propose to follow recent Commission Decisions to use adjusted test-
 10 year revenues in the application of the Arizona Department of Revenue ("ADOR") formula in order
 11 to determine allowed property tax expense.¹¹⁶ As in many past rate cases, RUCO disagrees with this
 12 methodology, and proposes the use of either the "ADOR methodology of averaging three historical
 13 years, or RUCO's new alternative of adding the last known and measurable property tax expense and
 14 the property tax expense associated with the additional increment of adjusted proposed revenue
 15 approved by the Commission."¹¹⁷ RUCO attached as an exhibit to its closing brief a new schedule
 16 showing the effect of RUCO's new alternative methodology on the proposed revenues of the
 17 parties.¹¹⁸ RUCO states that the Company collected nearly \$300,000 more property tax expense than
 18 it actually paid in the three years from 2006 to 2008, due to a decrease in the Company's property tax
 19 assessment, which RUCO states was "due in great part to the reduction in tax rate and the tax
 20 assessment ratio, adopted by the Arizona Legislature in HB 2779 and codified at A.R.S. § 41-
 21 15002."¹¹⁹ RUCO argues that if the methodology it advocates had been used in the prior rate case,
 22 averaging the three prior years of reported gross revenue by a factor of two, would have resulted in
 23 \$19,000 less in allowed property tax expense.¹²⁰ The Company disagrees with RUCO's claim that it
 24 has overcollected property tax expense. The Company argues that having consistently failed to earn

25 ¹¹⁵ Company Reply Brief at 3.

26 ¹¹⁶ Direct Testimony of Staff witness Marvin E. Millsap (Exh. S-2) Schedule MEM-25; Rebuttal Testimony of Company
 witness Thomas J. Bourassa (Exh. A-5) at 17.

27 ¹¹⁷ RUCO Reply Brief at 12.

27 ¹¹⁸ RUCO Brief, Exhibit A.

28 ¹¹⁹ RUCO Brief at 12, citing Surrebuttal Testimony of RUCO witness Timothy J. Coley (Exh. R-9) at 31-32.

¹²⁰ RUCO Brief at 12, citing Surrebuttal Testimony of RUCO witness Timothy J. Coley (Exh. R-9) at 38-41.

1 sufficient revenue to earn its authorized rate of return every year since the current rates went into
 2 effect, the Company has not over-recovered anything, rendering RUCO’s argument illusory.¹²¹ The
 3 Company contends that RUCO’s claim demonstrates the danger of singling out one expense to
 4 evaluate over-or under-recovery, and that RUCO’s contention that the Company “overcollected”
 5 property taxes is both misleading and untrue.¹²² Staff argues that because RUCO has provided no
 6 other substantive basis for deviating from the methodology the Commission has consistently utilized
 7 in calculating property tax expense, that the Commission should adopt the methodology used by the
 8 Company and RUCO in this case.¹²³

9 We agree with RUCO that the difference in the estimated property tax in the last rate case and
 10 the amount of property tax paid in the years from 2006 to 2008 was due largely to tax rate and tax
 11 assessment ratio changes, and not to the methodology used to estimate the Company’s property tax
 12 expense.¹²⁴ And we agree with the Company that looking at a single expense allowance from a prior
 13 rate case in order to judge expense under- or over-collection, can be misleading and should be
 14 avoided, as should any other single-issue ratemaking exercise. Unlike many test year expenses, a
 15 determination of property tax expense involves a forward-looking estimation. Using the revenue-
 16 dependent methodology based on the ADOR formula that has repeatedly been approved by the
 17 Commission, Staff and the Company utilized adjusted test-year revenues in the application of the
 18 ADOR formula to estimate the Company’s future property tax expense, in order to determine an
 19 appropriate allowed expense level based on that estimation. Staff’s method calculates the appropriate
 20 level of ongoing property tax expense for the revenue requirement by including a component for
 21 property taxes that reflects known assessment ratios and tax rates in the gross revenue conversion
 22 factor.¹²⁵ RUCO’s arguments in this case do not provide a basis for requiring any changes to the
 23 simple, accurate, reliable and reasonable methodology we have approved in past cases and again
 24 adopt in this case.

26 ¹²¹ Company Reply Brief at 15.
 27 ¹²² Company Brief at 17, citing Tr. at 158-59.
 28 ¹²³ Staff Reply Brief at 9.
¹²⁴ RUCO Brief at 12.
¹²⁵ Staff Brief at 10.

1 **B. Expense Normalization**

2 Staff proposes adjustments to normalize test year Chemical Expenses and Repairs and
3 Maintenance Expenses. The Company opposes both normalization adjustments.

4 Chemical Expenses

5 Staff's proposed normalization of Chemical Expenses would reduce the test year expense
6 level from \$127,457 to \$99,827, which is the three-year average of the Company's chemical expenses
7 for 2004, 2005, and the test year, 2006. The expenses in 2004 were \$66,210; in 2005, \$105,814; and
8 in 2006, \$127,457. Staff asserts that the normalization is appropriate because the Company's
9 chemical expenses have more than doubled subsequent to the Company's prior test year of 2003, and
10 because there were two large invoices totaling approximately \$17,000 for chemicals delivered in
11 December, 2006 that Staff believes were to be used post test year.¹²⁶ Staff asserts that the December
12 2006 invoices were for deliveries not made on a monthly basis, but over longer time periods, and that
13 Staff believed those chemicals were for use in the following year, not the test year, and should
14 therefore not have been included in test year expenses.¹²⁷ Staff's witness also testified that he knew
15 that a new treatment plant had come online during the three-year time period he used for the
16 normalization averaging, so that he was aware that chemical expenses would increase.¹²⁸ The
17 Company disagrees with the normalization adjustment, contending that the test year is presumed to
18 be normal, and adjustments should be based on known and measurable changes.¹²⁹ We agree. In this
19 instance, it was known to Staff that due to the new treatment plant, chemical expenses would have
20 increased.¹³⁰ In regard to the December 2006 invoices, the record does not reflect any inquiry
21 demonstrating that Staff's assumption that the chemicals were not properly a test year expense was
22 correct. If so, it may have been proper to exclude them from test year expenses, but that is not what
23 Staff proposed. Even if Staff had shown that the invoice amounts should have been excluded, the
24 exclusion would not have justified a normalization adjustment. Because the record does not support
25 the normalization of Chemical Expense proposed by Staff, the actual test year expense will be

26 ¹²⁶ Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 33; Tr. at 384-85.

27 ¹²⁷ Tr. at 384-85.

28 ¹²⁸ *Id.*

¹²⁹ Company Brief at 19.

¹³⁰ Tr. at 384-85.

1 allowed instead.

2 Repairs and Maintenance Expense

3 Staff proposes a normalization adjustment to the Company's Repair and Maintenance
 4 Expense reducing the test year expense from \$104,609 to \$91,134. Staff believes that the fluctuation
 5 in this expense account, from \$96,152 in 2004, to \$72,640 in 2005, to \$104,609 in the test year,
 6 called for a normalization adjustment, based on Staff's opinion that there "does not appear to be any
 7 upward trending in these expenses."¹³¹ In addition, Staff proposes exclusion of \$5,543 of test year
 8 expenses booked in this account for the Company's payments to Pepsi Cola Company of Dallas for
 9 beverages for the Company's employees. The Company does not dispute that the \$5,543 should be
 10 disallowed. We agree with Staff that this is an expense that should be borne by the shareholders, not
 11 the ratepayers, and will not be allowed. The \$5,543 disallowance to test year expenses brings the test
 12 year level of repair and maintenance expense down to a level close to the 2004 level of expense,
 13 which, based on the evidence presented, is a reasonable level. Because the record does not support
 14 Staff's proposed normalization of Repairs and Maintenance Expense, the actual test year expense,
 15 less Staff's proposed disallowance of \$5,543, will be allowed.

16 **C. Deferral of CAP M&I Charges**

17 The Company and Staff agree that the Company should be allowed recovery of 50 percent of
 18 the CAP M&I charges related to the additional CAP allocation, or \$20,306, as an operating expense,
 19 based on Staff's position that only 50 percent of the additional CAP allocation is used and useful at
 20 this time, and that 50 percent of the charges should be deferred.¹³² Staff filed in this docket proposed
 21 accounting order language which would allow the deferral of the remaining 50 percent of the M&I
 22 charges.¹³³ RUCO states that if it is determined that some portion of the additional CAP allocation is
 23 used and useful, a commensurate portion of the associated annual water service capital charge should
 24 be included as an M&I expense in this case.¹³⁴ RUCO does not oppose the accounting order
 25 language as to form.¹³⁵ The Company disagrees with language in Staff's accounting order proposal

26 ¹³¹ Testimony of Staff witness Marvin E. Millsap (Exh. S-2) at 34; Staff Reply Brief at 4.

27 ¹³² Company Brief at 11, 20-21; Staff Reply Brief at 4.

28 ¹³³ Staff Proposed Accounting Order Language docketed on January 6, 2009.

¹³⁴ RUCO Reply Brief at 7.

¹³⁵ RUCO Response to Proposed Accounting Order, docketed on January 13, 2009.

1 allowing the Company a 36 month deferral period,¹³⁶ and included its own proposed accounting order
2 language as an attachment to its closing brief.¹³⁷

3 The Company and Staff disagree on two issues related to the deferral: (1) whether the
4 Company should be allowed to defer interest or other carrying charges, and (2) whether the deferral
5 should have a time limitation.

6 The Company asserts that until the recovery of interest or carrying costs can be considered in
7 a future rate case, the Company should be allowed to accrue reasonable carrying costs.¹³⁸ Staff
8 contends that it is inappropriate to allow the Company to accrue interest on the deferral, because 50
9 percent of the M&I charges are not currently used and useful.¹³⁹ As Staff notes, the interest and
10 timeframe requirements of Staff's proposal are consistent with other Commission Accounting
11 Orders.¹⁴⁰ Staff's language "excluding any interest or other carrying charges" is consistent with our
12 other Accounting Orders and will therefore be adopted.

13 The Company contends that there is no reason for "preset, artificial limits" on the deferral
14 period.¹⁴¹ Staff argues that without a specified timeframe, the Company would be able to defer the
15 charges indefinitely.¹⁴² Staff contends that 36 months is a reasonable timeframe for the deferral
16 period, and points out that its proposal also includes a provision allowing the Company to continue
17 the deferral beyond its evaluation in the Company's next rate case, such that the Staff proposal does
18 not specifically limit the deferral to 36 months.¹⁴³ Staff states that it proposed the 36 month
19 timeframe in order to permit time for Staff to evaluate whether the Company is properly accounting
20 for the deferral, and also to determine if all or a portion of the deferred charges are used and useful,
21 and therefore eligible to be placed in rates.¹⁴⁴ For the reasons provided by Staff, we agree that a
22 definite timeframe should be placed on the deferral period, and find that under the circumstances of
23 this case, a 48 month period is reasonable.

24 ¹³⁶ Company Brief at 21-22 and Exhibit 2.

25 ¹³⁷ Company Brief at Exhibit 2.

26 ¹³⁸ Company Brief at 21-22 and Exhibit 2.

27 ¹³⁹ Staff Reply Brief at 5.

28 ¹⁴⁰ *Id.*

¹⁴¹ Company Brief at 21-22 and Exhibit 2.

¹⁴² Staff Reply Brief at 5.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

1 **D. Rate Case Expense**

2 The Company requests authority to recover rate case expense associated with this case in the
 3 amount of \$280,000. The Company states that it based its request primarily on the \$285,000 amount
 4 awarded in its last rate proceeding, and that it has incurred more than \$280,000 in this proceeding.¹⁴⁵
 5 RUCO did not brief the issue of rate case expense for this case. Staff proposes that the Company be
 6 allowed to recover no more than \$150,000 in rate case expense for this proceeding, arguing that
 7 \$150,000 in rate case expense is similar to amounts the Commission has allowed comparably-sized
 8 utilities to recover through just and reasonable rates.¹⁴⁶ Staff recommends that rate case expense be
 9 normalized, instead of amortized.¹⁴⁷ The Company argues that Staff's opposition to the Company's
 10 request for this proceeding is not supported by the evidence, because Staff gave no consideration to
 11 the specifics of this rate case, to the rate case process, or to the similar rate case expense awards
 12 relied on by the Company, and because Staff could not provide specifics regarding the cases its
 13 witness relied on in reaching his recommendation.¹⁴⁸ The Company requests that if its rate case
 14 expense recovery is normalized, as Staff recommends, rather than amortized, that it be granted
 15 authority to institute a surcharge instead "to ensure that recovery actually occurs."¹⁴⁹ Based on our
 16 review of the record, we find that it is reasonable to allow recovery of \$280,000 for the expenses
 17 incurred by the Company in this proceeding. We agree with Staff that because rate case expense is a
 18 recurring expense, normalization is a more appropriate treatment than amortization, and that a
 19 surcharge for recovery of rate case expense would be inappropriate. The \$280,000 allowed rate case
 20 expense related to this proceeding will therefore be normalized over three years.

21 **E. Appeal and Remand Rate Case Expense**

22 In addition to the Company's requested recovery of rate case expenses associated with this
 23 proceeding, the Company has requested recovery in this docket of its rate case expenses associated
 24

25 _____
 26 ¹⁴⁵ Company Brief at 22, citing Rebuttal Testimony of Company witness Thomas J. Bourassa (Exh. A-5) at 15 and
 Rebuttal Testimony of Company witness Robert N. Hanford (Exh. A-2) at 10.

27 ¹⁴⁶ Staff Brief at 8.

28 ¹⁴⁷ *Id.*

¹⁴⁸ Company Brief at 24, citing Tr. at 390-98.

¹⁴⁹ Company Reply Brief at 6.

1 with the Remand Proceeding, as allowed by Decision No. 70441.¹⁵⁰ The Company originally
 2 requested recovery of \$258,111 of the \$500,000 of rate case expense it incurred in its appeal of
 3 Decision No. 68176 and the Remand Proceeding, which included expert witness fees, copying,
 4 mailing and publication costs, and discounted legal fees.¹⁵¹ The Company currently requests
 5 recovery of \$100,000 of these expenses through operating expenses, together with the \$280,000 in
 6 expenses associated with this proceeding, discussed above, for a total recovery of \$380,000,
 7 amortized over three years, resulting in a total annual expense of \$126,667 reflected in the revenue
 8 requirement for this case.¹⁵² Staff recommends that the Company be permitted to recover \$100,000
 9 in rate case expense related to the Remand Proceeding, normalized over a three year period, which,
 10 with its recommendation of recovery of \$150,000 related to the current proceeding, would result in
 11 total rate case expense of \$250,000, normalized over a three year period, for a total annual rate case
 12 expense of \$83,333 reflected in the revenue requirement for this case.¹⁵³ RUCO recommends denial
 13 of any rate case expense recovery related to the Company's appeal of Decision No. 68176 and the
 14 Remand Proceeding, and RUCO's final schedules show total annual rate case expense of \$93,333
 15 reflected in the revenue requirement for this case.¹⁵⁴

16
 17 RUCO argues that the Company's request for legal fees for the appeal and remand of
 18 Decision No. 68176 should be denied "as a matter of law and public policy."¹⁵⁵ RUCO argues that
 19 "[a]lthough the appeal and remand corrected the method by which the Commission determined
 20 FVRB rate of return, the Company pursued the appeal to obtain additional operating income for the
 21 benefit of its shareholders,"¹⁵⁶ and contends that the shareholders should therefore bear the costs
 22 associated with that lawsuit, and the Company should "pay the costs for its business decision to
 23 pursue an appeal."¹⁵⁷ RUCO argues that "[p]ermitting the Company to recover its rate case expense
 24 on a lawsuit to benefit shareholders would leave the utilities with the expectation that they can pursue

25 ¹⁵⁰ Decision No. 70441 at 43.

26 ¹⁵¹ Supplemental Direct Testimony of Company witness Thomas J. Bourassa (Exh. A-4) at 2-7.

27 ¹⁵² Company Reply Brief at 6.

28 ¹⁵³ Staff Brief at 7-8.

¹⁵⁴ RUCO Final Schedule TJC-27.

¹⁵⁵ RUCO Reply Brief at 12.

¹⁵⁶ RUCO Brief at 11.

¹⁵⁷ *Id.*

1 any lawsuit with no worry of the costs associated therewith because captive ratepayers will pick up
2 the tab.”¹⁵⁸

3
4 The Company contends that it is in the public interest to ensure the legality of Commission
5 Decisions, and therefore the Company should not bear the entire burden of the expense it incurred to
6 appeal a Decision for which the Company was not responsible, and which the court found
7 unlawful.¹⁵⁹ The Company also states that contrary to RUCO’s assertion that a utility “can pursue
8 any lawsuit with no worry of the costs,” a utility has no expectation of any expense recovery unless it
9 prevails in its appeal, and that even if a Company is successful, full recovery of expenses is
10 unlikely.¹⁶⁰

11 RUCO advances the argument that that Arizona law does not permit recovery of attorney’s
12 fees on remand, citing A.R.S. § 12-348 and *Columbia Parcar Corp. v. Arizona Dept. of*
13 *Transportation*.¹⁶¹ *Columbia Parcar* held that plaintiffs did not prevail in adjudication “on the
14 merits” on judicial review by securing reversal and remand for new hearing on procedural grounds,
15 and thus were not entitled to award of fees. In *Columbia Parcar*, in the administrative proceeding
16 leading to the appeal, plaintiffs were not allowed to present evidence on statutory requirements
17 related to their claim.¹⁶² The facts of *Columbia Parcar* are therefore distinguishable from the facts in
18 this case, as CCWC did not secure its remand of Decision No. 68176 on procedural grounds, but
19 because it prevailed on the merits of its appeal of a specific ratemaking issue. We also agree with the
20 Company that the statute cited by RUCO does not apply to this case, as A.R.S. § 12-348(H)(1) does
21 not apply to actions “to establish or fix a rate.”¹⁶³

22 _____
¹⁵⁸ *Id.* 11.

23 ¹⁵⁹ Company Brief at 24.

24 ¹⁶⁰ Company Reply Brief at 16.

25 ¹⁶¹ RUCO Brief at 10, citing *Columbia Parcar Corp. v. Arizona Dept. of Transportation*, 193 Ariz. 181, 971 P.2d 1042
(App. 1999).

26 ¹⁶² *Columbia Parcar*, 193 Ariz. at 183, 971 P.2d at 1043.

27 ¹⁶³ A.R.S. § 12-348(H)(1) provides:

28 This section does not:

1. Apply to an action arising from a proceeding before this state or a city, town or county in which the role of this state or a city, town or county was to determine the eligibility or entitlement of an individual to a monetary benefit or its equivalent, to adjudicate a dispute or issue between private parties or to establish or fix a rate.

1 In its appeal of Decision No. 68176 in the Company's prior rate case, the Company prevailed
2 in its arguments on the issue that the court remanded to the Commission. Subsequently, the
3 Company incurred additional costs in prosecuting its case in the remand proceeding. As Staff argues,
4 this Commission has the authority to award such costs, and under the circumstances of this case, it is
5 reasonable and rational to award a portion of those costs.¹⁶⁴ While there certainly may be instances
6 in which recovery of rate case expenses is contravened by public policy, we are not convinced by
7 RUCO's argument that public policy calls for denial of the Company's request for partial recovery of
8 its costs in this case. In the circumstances of this case, we find that it is in the public interest to award
9 the Company \$100,000 in rate case expenses related to the remand proceeding.
10

11 The Company requests that if the recovery is normalized rather than amortized, that it be
12 granted authority to institute a surcharge instead "to ensure that recovery actually occurs."¹⁶⁵ As
13 stated above in the discussion of rate case expense recovery for this proceeding, normalization of rate
14 case expense is a proper ratemaking treatment, and a surcharge for recovery of rate case expense
15 would be inappropriate. We find that it is in the public interest to authorize the Company to recover a
16 total of \$380,000 in rate case expense, including \$280,000 associated with this proceeding, and
17 \$100,000 associated with the appeal of Decision No. 68176 and the Remand Proceeding. The
18 recovery will be normalized over three years, resulting in a total annual expense of \$126,667
19 reflected in the revenue requirement for this case.
20
21

22 F. Operating Income Summary

23 With the adjustments discussed above, we find the Company's test year operating expenses to
24 be \$6,578,383, on adjusted test year revenues of \$7,505,010, for adjusted test year operating income
25 of \$926,627.
26

27
28 ¹⁶⁴ Staff Reply Brief at 8-9.

¹⁶⁵ Company Reply Brief at 6.

1 **VI. COST OF CAPITAL**

2 The parties to this case recommend a rate of return for the Company as follows: CCWC, 9.96
3 percent; RUCO, 6.38 percent;¹⁶⁶ and Staff, 7.6 percent.¹⁶⁷ For the reasons discussed below, we adopt
4 a FVROR for the Company of 7.52 percent.

5
6 **A. Capital Structure and Cost of Debt**

7 Capital Structure

8 The parties are generally in agreement regarding CCWC's capital structure. The Company
9 proposes a capital structure consisting of 3.97 percent short-term debt, 19.45 percent long-term debt,
10 and 76.58 percent equity. RUCO recommends a capital structure comprised of 4.08 percent short-
11 term debt, 19.17 percent long-term debt, and 76.75 percent common equity. Staff proposes a capital
12 structure of 75.6 percent equity and 24.4 percent debt. The minor differences in the parties'
13 recommendations are attributable to the Company's use of the capital structure at the end of the test
14 year, while Staff and RUCO used a more recent capital structure.¹⁶⁸ Based on the parties' proposals,
15 we find that a capital structure of 24 percent debt and 76 percent equity is reasonable for the
16 Company in this case.

17 Cost of Debt

18 The Company proposes a cost of short-term debt of 2.88 percent, which it based on the
19 London Inter-Bank Offered Rate ("LIBOR") reported on November 21, 2008.¹⁶⁹ CCWC's short term
20 debt is provided by its parent, American States Water Company, subject to variable interest rates
21 based on the LIBOR.¹⁷⁰ CCWC's proposed cost of long-term debt, 5.33 percent, is based on the end
22 of test year interest rate on its low-cost bonds issued in 1997,¹⁷¹ for an overall cost of debt of 4.92
23 percent.¹⁷² RUCO recommends a cost of short-term debt of 2.71 percent, and a cost of long-term
24 debt of 5.34 percent. Staff proposes a composite cost of long-term and short-term debt of 5.0 percent,

25 ¹⁶⁶ RUCO Final Schedule TJC-36.

26 ¹⁶⁷ Staff Final Schedule PMC-2.

27 ¹⁶⁸ See Cost of Capital ("COC") Rejoinder Testimony of Company witness Thomas J. Bourassa (Exh. A-21) at 4-5.

28 ¹⁶⁹ Company COC Brief ("Brief") at 31.

¹⁷⁰ *Id.*

¹⁷¹ See Company Amended Final Sched. D-2.

¹⁷² Staff COC Brief at 2.

1 which takes into account changes to the Company's long-term debt occurring after the test year.¹⁷³
 2 Based on the parties' proposals, we find that the 5.0 percent composite cost of debt recommended by
 3 Staff is reasonable, and will adopt it.

4 **B. Cost of Equity**

5
 6 Using the DCF and CAPM models, the Company's cost of capital witness estimated the
 7 Company's cost of equity to be 12.7 percent. The Company states that although it believes its current
 8 cost of equity is 12.7 percent, it has requested a cost of equity of 11.5 percent in order to minimize
 9 disputes.¹⁷⁴ Staff's cost of equity estimate is 10.1 percent.¹⁷⁵ RUCO's unadjusted cost of equity
 10 estimate is 8.83 percent.¹⁷⁶

11 While the Company and Staff used the same six publicly traded water companies as a sample
 12 group in their cost of equity analyses, RUCO's sample group differed. The Company disagrees with
 13 the group of publicly traded utilities RUCO used to estimate CCWC's cost of equity. In particular,
 14 CCWC disagrees with RUCO's substitution of Southwest Water Company for Connecticut Water
 15 Service, Middlesex Water Company, and SJW Corporation. RUCO asserts that Southwest Water
 16 Company is an appropriate comparable company because American States Water, CCWC's parent
 17 company, offers nearly identical service as Southwest Water Company, including unregulated
 18 services, and has an identical risk as Southwest Water Company, demonstrated by the fact that the
 19 two companies share the same market beta¹⁷⁷ of 1.05, as reported in Value Line Utility Reports.¹⁷⁸
 20 CCWC argues that Southwest Water Company is not comparable to either CCWC or to the publicly
 21 traded water utilities in the sample group used by CCWC and Staff in their cost of equity estimates.
 22 CCWC states that according to AUS Utility Reports (November 2008) only 45 percent of Southwest
 23 Water Company's revenues are derived from regulated activities, whereas four of the six water
 24

25 ¹⁷³ Staff Final Sched. PMC-10.

26 ¹⁷⁴ Company COC Brief at 2.

27 ¹⁷⁵ Staff Final Schedule PMC-1.

28 ¹⁷⁶ RUCO Final Schedule TJC-36. RUCO refers to this as the "OCRB Weighted Cost of Capital."

¹⁷⁷ Beta measures the systematic risk of a particular entity's stock relative to the market's beta, which is 1.0. Since the market's beta is 1.0, a security with a beta higher than 1.0 is riskier than the market and a security with a beta lower than 1.0 is less risky than the market. See Direct Testimony of Staff Witness Pedro M. Chaves, (Exh. A-16) at 29.

¹⁷⁸ RUCO COC Brief at 8, RUCO COC Reply Brief at 4.

1 utilities used by CCWC and Staff have at least 90 percent of their revenue derived from regulated
2 activities, and the remaining two have 82 percent and 85 percent of their revenues derived from
3 regulated activities.¹⁷⁹ CCWC argues that in comparison to Southwest Water's 45 percent of
4 revenues from regulated activities, 86 percent of CCWC's parent company American States Water's
5 revenues and 96 percent of its net income were generated by its principal subsidiary, Golden State
6 Water Company, which also owns 92 percent of American States Water's assets, but CCWC did not
7 specify the percentage of those revenues derived from regulated services.¹⁸⁰ CCWC also argues that
8 Southwest Water Company's earnings per share were negative for the twelve-month period ended
9 June 30, 2008, and that RUCO's use of this financially troubled company in its proxy group
10 depressed RUCO's cost of equity estimate by 60 basis points.¹⁸¹ CCWC contends that *Sun City*
11 *Water Co. v. Arizona Corp. Comm'n*¹⁸² supports its position that Southwest Water should be
12 excluded from RUCO's proxy group because it is "financially sick."¹⁸³ We disagree. The facts in the
13 *Sun City* case are distinguishable from this case in two significant ways. First, the court in the *Sun*
14 *City* case did not address the use of companies in a proxy group for either a DCF or CAPM analysis,
15 and was instead criticizing the use of comparative earnings analysis for setting a rate of return for the
16 water utility in question.¹⁸⁴ A comparative earnings analysis, which is not proposed by any party to
17 this case, differs greatly from the DCF and CAPM analyses in the use of companies for comparison
18 purposes. Second, the *Sun City* court referred not to an individual "financially sick" company, but to
19 the "financially sick" condition of the water utility industry as a whole at that time, while criticizing
20 the comparative earnings analysis used in that case as being particularly inappropriate "when
21 evidence was presented that this industry was generally sick financially".¹⁸⁵

22
23 The Company also disagrees with RUCO's use of a sample group of natural gas distribution
24 utilities, and argues that an adjustment must be made to account for their use as proxies. RUCO

25 ¹⁷⁹ COC Rejoinder Testimony of Company witness Thomas J. Bourassa (Exh. A-21) at 28.

26 ¹⁸⁰ Company COC Reply Brief at 18-19.

27 ¹⁸¹ *Id.* at 35, citing Rigsby Dt., Sched. WAR-2.

28 ¹⁸² *Sun City Water Company v. Arizona Corp. Comm'n*, 26 Ariz. App. 304, 310, 547 P.2d 1104, 1110 (App. 1976), *rev'd on other grounds*, 113 Ariz. 464, 556 P.2d 1126 (1976).

¹⁸³ Company COC Reply Brief at 19.

¹⁸⁴ *Sun City Water Company*, 26 Ariz. App. at 310, 547 P.2d at 1110.

¹⁸⁵ *Id.*

1 states that gas utilities serve as an appropriate proxy for CCWC because gas and water companies
 2 have similar operating characteristics in terms of distribution and similar risks.¹⁸⁶ CCWC asserts that
 3 because RUCO's water utility proxy group, with an average beta of 0.82, has more systematic
 4 (market) risk than its gas utility proxy group, with an average beta of 1.05, that the gas proxy group is
 5 not comparable to CCWC.¹⁸⁷ CCWC argues that because the gas proxy group's average beta is
 6 higher than the water proxy group's, an adjustment must be made to account for the current
 7 difference in risk between a typical water utility and a typical gas utility.¹⁸⁸ CCWC asserts that
 8 Commission Decision No. 66849 "rejected the use of gas companies as proxies for a water utility
 9 based on the difference between the average beta of the water utility sample group and average beta
 10 of the gas utility sample group," that "use of the gas utility sample as a proxy for the water utility
 11 would have increased the cost of equity,"¹⁸⁹ and that Staff's position in the case leading to Decision
 12 No. 66849 supports a 250 basis point upward adjustment in this case.¹⁹⁰ Decision No. 66849 does
 13 not support such an adjustment. Contrary to the Company's assertion, Decision No. 66849 did not
 14 reject Staff's use of a gas proxy group. However, it did reject Staff's position that its use of gas
 15 proxies necessitated a downward adjustment to Staff's cost of equity estimate. Decision No. 66849
 16 instead adopted Staff's unadjusted average of its DCF and CAPM models. The use of a gas utility
 17 sample had the effect of increasing the cost of equity over Staff's recommendation in that case.¹⁹¹
 18 The Company's argument that a failure in this case to make an upward adjustment would constitute
 19 an arbitrary and capricious action¹⁹² is simply wrong. In this case, as RUCO points out, CCWC itself
 20 used water utilities with the same range of beta as RUCO's gas proxy; one third of the companies in
 21 CCWC's water proxy group have the same range of betas as the companies in RUCO's gas proxy
 22 group; nine of the ten gas utilities in RUCO's gas proxy have betas between 0.80 and 0.90; the
 23 Company's proxy group of six water companies included Connecticut and Middlesex Water

24 ¹⁸⁶ RUCO COC Brief at 7.

25 ¹⁸⁷ Company COC Brief at 36.

26 ¹⁸⁸ *Id.*

27 ¹⁸⁹ Company COC Reply Brief at 19-20, citing Decision No. 66849 (March 19, 2004) *In the Matter of the Application of Arizona Water Company, an Arizona Corporation, for Adjustments to its Rates and Charges for Utility Service Furnished by its Eastern Group and for Certain Related Approvals* at 21.

28 ¹⁹⁰ Company COC Reply Brief at 20.

¹⁹¹ Decision No. 66849 at 23.

¹⁹² See Company COC Reply Brief at 20.

1 Companies, which have betas ranging between 0.80 and 0.90;¹⁹³ and testimony on the record
 2 indicates that there is movement toward using gas utility proxies to derive cost of capital for water
 3 companies.¹⁹⁴ The record does not reflect a need for a special adjustment due to RUCO's use of
 4 natural gas distribution utilities as proxies.

5 While the Company arrived at its CAPM cost of equity estimate of 14.6 percent by averaging
 6 its historical market risk premium result of 9.8 percent with its 19.4 percent current market risk
 7 premium result, RUCO did not use a current market risk premium, but reached its CAPM estimate
 8 based on a historic market risk premium.¹⁹⁵ RUCO calculated a range for its CAPM cost of equity
 9 between 8.10 and 9.78 percent for its water sample, and between 6.94 and 8.25 percent for its gas
 10 sample.¹⁹⁶ RUCO contends that because reliance on past performance is a better indicator of future
 11 performance than reliance on analyst's projections of market return and treasury yields, RUCO's use
 12 of a historic market risk premium to derive a CAPM cost of equity capital is appropriate, particularly
 13 in the current economic circumstances.¹⁹⁷ While the Company argues that market volatility does not
 14 make the CAPM unstable or subject to manipulation,¹⁹⁸ RUCO concurs with Staff's witness David
 15 Parcell that the current risk premium CAPM is not a proper model in a very depressed market, and
 16 that the Company's CAPM analysis should be rejected because it is based, in part, on a current
 17 market risk premium.¹⁹⁹ RUCO agrees with Mr. Parcell that development of a growth rate from
 18 stocks priced in an extremely depressed market leads to a CAPM which is too high.²⁰⁰ RUCO further
 19 argues that the Company's use of a 19.4 percent current market risk premium to determine a cost of
 20 equity capital is inconsistent with the most recently available market data, comparing it to Value
 21 Line's October 24, 2008 projections of 7.50 percent for the return on common equity for the water
 22 industry through the five year period through 2013, for a difference of 1,190 basis points.²⁰¹ We
 23

24 ¹⁹³ RUCO COC Brief at 6-7.

25 ¹⁹⁴ *Id.* at 7, citing Tr. at 776-77.

26 ¹⁹⁵ RUCO COC Brief at 2.

27 ¹⁹⁶ COC Direct Testimony of RUCO witness William A. Rigsby (Exh. R-14) at 333-34.

28 ¹⁹⁷ RUCO COC Brief at 3, RUCO COC Reply Brief at 8.

¹⁹⁸ Company COC Reply Brief at 15.

¹⁹⁹ RUCO COC Brief at 4, citing David Parcell's testimony, Tr. at 746, 759-761.

²⁰⁰ RUCO COC Reply Br at 7-8, citing Staff witness David Parcell's testimony, Tr. at 759.

²⁰¹ RUCO COC Reply Brief at 8, citing Company witness Thomas Bourassa's testimony, Tr. at 580.

1 agree with RUCO and Staff that the Company's CAPM should be rejected because it is based, in part
2 on a current market risk premium, which is inappropriate in a depressed market.

3
4 The Company asserts that RUCO significantly reduced its CAPM cost of equity estimate by
5 using a geometric mean to calculate the market risk premium, by using two different Treasury
6 securities as its proxy for the risk-free rate of return, and by using the average total return, instead of
7 the average income return, on risk-free Treasuries.²⁰² RUCO derived its historic market premium
8 using both a geometric and an arithmetic mean of the historical returns on the Standard and Poor's
9 500 ("S&P 500") index from 1926 to 2007 as the proxy for the market rate of return.²⁰³ RUCO states
10 that the use of geometric mean is the industry standard, that geometric means are published in
11 Morningstar, and that Value Line calculates both historic and prospective growth rates on a geometric
12 or compound growth rate basis.²⁰⁴ RUCO also argues that its historic market risk premium range of
13 between 4.90 percent and 6.5 percent, for an average of 5.7 percent, falls close to the range of 4.0 to
14 5.0 percent identified as reasonable in a recent professional presentation,²⁰⁵ and the range of 4.5 to
15 5.5 percent identified as reasonable in a recent publication cited in this case by both the Company and
16 RUCO.²⁰⁶ RUCO contends that because its historic market risk premium falls close to the range
17 identified as reasonable by recent empirical research, and the Company's historic market risk
18 premium using an arithmetic mean of 7.5 percent does not, the Company's cost of equity
19 recommendation should be rejected.²⁰⁷ CCWC argues, unconvincingly, that RUCO's use of an
20 excerpt from the Koller, Goedhart, and Wessels text²⁰⁸ (to which the Company cited as supporting a
21 separate issue) fails to support RUCO's contention that its market risk premium of 5.7 percent, the
22 average of its geometric and arithmetic mean, is reasonable, because the risk premium in this case is

23 ²⁰² Company COC Brief at 40-49.

24 ²⁰³ RUCO COC Brief at 4.

25 ²⁰⁴ *Id.* at 4-5.

26 ²⁰⁵ *Id.* at 5, citing opinions given by Dr. Aswarth Damdaran, New York University professor of finance and Dr. Felicia C. Marston, University of Virginia professor of finance during a panel discussion presentation at the 39th Annual Financial Forum of the Society of Utility and Regulatory Financial Analysts held April 19 and 20, 2007, at Georgetown University.

27 ²⁰⁶ RUCO COC Brief at 5, citing *Valuation: Measuring and Managing the Value of Companies*, 4th Ed., 2005, by McKinsey & Company, Inc., Koller, Goedhart, and Wessels, p. 306.

28 ²⁰⁷ RUCO COC Brief at 5.

²⁰⁸ *Valuation: Measuring and Managing the Value of Companies*, 4th Ed., 2005, by McKinsey & Company, Inc., Koller, Goedhart, and Wessels, p. 306.

1 not being computed with short-term bonds, and because the Company's calculations are not found in
2 a textbook.²⁰⁹ The Company argues that its 7.5 percent historic market risk premium is not too high,
3 as RUCO contends, because both Staff and the Company used the arithmetic mean published in the
4 *2008 Ibbotson SBBI Valuation Edition Yearbook* (Morningstar 2008), which calculates the historic
5 risk premium by averaging the historic arithmetic differences between the S&P 500 and intermediate-
6 term government bond income returns for the period 1926 through 2007, and RUCO "has presented
7 no evidence that *Ibbotson's* calculations are erroneous."²¹⁰ Staff's witness Mr. Parcell states that
8 because investors use both arithmetic and geometric average returns, both should be considered in the
9 development of a risk premium.²¹¹ Mr. Parcell states that exclusive use of arithmetic averages leads
10 to a higher, and potentially excessive risk premium, and thus CAPM results, because arithmetic
11 averages exceed geometric averages.²¹² Although Staff has traditionally used arithmetic averages as
12 a component of its historic risk premium, Staff's witness Mr. Parcell's testimony supports RUCO's
13 use of both arithmetic and geometric averages in the development of the historic market risk
14 premium.

15
16 In response to CCWC's assertion that RUCO significantly reduced its CAPM cost of equity
17 estimate by using two different Treasury securities as its proxy for the risk-free rate of return, and by
18 using the average total return, instead of the average income return, on risk-free Treasuries, RUCO
19 states that initially, it used both intermediate and long-term securities to estimate the risk-free rate of
20 return, but then recalculated its historic market risk premium, using matching intermediate treasuries
21 as advocated by the Company, and that the impact of recalculating its cost of equity capital estimate
22 based on the Company's methodology would be an increase of 10 basis points, from 6.38 percent to
23 6.48 percent.²¹³ RUCO explains that it is not modifying its recommendation, because its
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26 ²⁰⁹ Company COC Reply Brief at 17.

27 ²¹⁰ *Id.*

27 ²¹¹ Surrebuttal Testimony of Staff witness David C. Parcell (Exh. S-7) at 10.

28 ²¹² *Id.*

28 ²¹³ RUCO COC Reply Brief at 6.

1 recommendation of 6.38 percent is based on a market risk premium that already exceeds the market
2 risk premium recommended by the authorities on which RUCO relied.²¹⁴

3
4 CCWC asserts that RUCO's reliance on only the sustainable growth method to estimate the
5 dividend growth component of its constant growth DCF estimate also causes RUCO's cost of equity
6 estimate to be understated.²¹⁵ CCWC argues that RUCO failed to disclose the key inputs necessary to
7 estimate the internal or retention growth rate it used in the constant growth DCF model, and the
8 estimate should be rejected because it cannot be reproduced or updated based on more current market
9 data or information.²¹⁶ RUCO responds that this argument is a red herring, as there was essentially
10 no difference between the parties' cost of capital experts' estimates of average sustainable growth for
11 water utility proxies.²¹⁷ RUCO points out that CCWC's cost of capital expert estimated the average
12 sustainable growth to be 6.39 percent for his water utility sample, leaving a difference of only 9 basis
13 points between the Company's estimate and RUCO's estimate, which was 6.30 percent.²¹⁸

14 CCWC argues that because Mr. Parcell testified that he was required to accept the models and
15 inputs used by Staff's witness, Mr. Chaves, to estimate CCWC's cost of equity, Mr. Parcell's
16 testimony has *limited relevance* to this case.²¹⁹ Until it filed its reply brief, the Company's arguments
17 actually ignored Staff's recommended cost of equity of 10.1 percent, apparently preferring to argue
18 that "Staff's final recommendation is 11.9 percent," and that Staff's recommendation is "not affected
19 by recent market volatility and related events."²²⁰ The Company also argued that the only aspect of
20 Mr. Chaves' methods Mr. Parcell actually disagreed with was that Staff's current market risk
21 premium estimate was too high due to current market volatility.²²¹ Because Staff filed surrebuttal
22 testimony withdrawing its recommendation for a Hamada adjustment prior to the hearing,²²² The

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²¹⁴ *Id.* at 7.

²¹⁵ Company COC Brief at 38.

²¹⁶ *Id.* at 38-39

²¹⁷ RUCO COC Reply Brief at 2.

²¹⁸ *Id.*

²¹⁹ Company COC Brief at 49.

²²⁰ *Id.* at 50-51(emphasis in original).

²²¹ *Id.* at 50.

²²² Surrebuttal Testimony of Staff witness David C. Parcell (Exh. S-7) at 12.

1 Company's post-hearing brief argument against the "recommended 180 basis point downward
2 adjustment to [Staff's] 11.9 percent cost of equity estimate"²²³ is misplaced and irrelevant.

3 Staff is critical of the Company's use, in the current economic environment, of spot stock
4 prices in its DCF and CAPM models.²²⁴ Staff argues that these are not normal times, and that times
5 such as these may require a departure from methods the Commission has previously relied on.²²⁵
6 Staff's witness testified that market models such as the DCF and CAPM are forward looking, and
7 assume that stock prices and interest rates reflect current expectations of the future, but that such
8 assumptions are not applicable in today's economic environment.²²⁶

9
10 The Company asserts that the riskiness of the sample water utilities the parties used to
11 estimate cost of equity has increased since CCWC's last rate case, as shown by the sample
12 companies' increase in their average beta, which the Company states is currently 0.93, while the
13 average beta for the same proxy group was 0.68.²²⁷ The Company argues that the fact that the
14 markets are riskier now than in previous years requires a higher cost of equity than CCWC was
15 authorized in its prior case, in order to allow it to continue to attract capital.²²⁸ Staff notes that its
16 cost of equity recommendation of 10.1 percent constitutes an 80 basis point increase from the 9.3
17 percent cost of equity as determined in Decision No. 68176 and upheld by the Court of Appeals, but
18 that the Company's cost of equity estimate of 11.5 percent constitutes an increase of 220 basis points.
19 ²²⁹ Staff contends that the Company has failed to justify such a large increase in its cost of equity.²³⁰

20 We certainly recognize that current market conditions present increased risks over recent
21 years for many companies. However, we do not find that a general increased level of risk justifies
22 the cost of equity requested by the Company. While the Company is critical of the inputs RUCO and
23 Staff chose to use in their cost of equity estimation models, as discussed herein, several of the
24

25 ²²³ Company COC Brief at 52-55.

26 ²²⁴ Staff COC Brief at 6.

27 ²²⁵ *Id.*

28 ²²⁶ Tr. at 740.

²²⁷ Company COC Brief at 1.

²²⁸ Company COC Reply Brief at 10-11.

²²⁹ Staff COC Reply Brief at 3.

²³⁰ *Id.*

1 Company's arguments against them are unsupported by the facts. Taken in total, we find the
 2 methodologies Staff and RUCO used to be less biased than those used by the Company, and more
 3 reasonable and more reflective of current market conditions. Based on the analyses presented, we
 4 find a cost of common equity of 9.9 percent to be reasonable in this case.

5 **C. Cost of Capital Summary**

	Percentage	Cost	Weighted Cost
7 Debt	24.0	5.0%	1.20%
8 Common Equity	76.0	9.9%	<u>7.52%</u>
9 <u>Weighted Average Cost of Capital</u>			<u>8.72%</u>

10
 11 **D. Fair Value Rate of Return**

12 CCWC's most recent rate proceeding, which resulted in Decision No. 68176, was the subject
 13 of an Arizona Court of Appeals decision which ordered a remand to this Commission on the issue of
 14 the method used to calculate operating income. Decision No. 68176 determined operating income
 15 and set rates in a manner consistent with prior Commission decisions, by multiplying the weighted
 16 average cost of capital ("WACC") by the OCRB, and dividing the resulting product by the FVRB²³¹
 17 in order to determine a FVROR. Under that method, the operating income, determined by
 18 multiplying the FVRB times the FVROR, provided the same operating income as multiplying the
 19 WACC by the OCRB.

20 Following the Remand Proceeding ordered by the Arizona Court of Appeals, a hearing was
 21 held and Decision No. 70441 (July 28, 2008) was issued. Decision No. 70441 did not adopt the
 22 Company's proposal to determine a FVROR by applying the WACC directly to the FVRB, but
 23 revised the method used in Decision No. 68176 to calculate operating income. The Commission
 24 found that applying the WACC to the FVRB would over-compensate the Company for inflation and
 25 calculated the FVROR by adjusting the WACC to reflect an inflation adjustment that reduced the cost
 26

27
 28 ²³¹ In Decision No. 70441 and in this case, the FVRB reflects a 50/50 weighting of OCRB and RCND.

1 of equity.²³² The FVROR was then applied to the FVRB to determine operating income. Decision
 2 No. 70441 found that the evidence presented in the Remand Proceeding was not sufficiently
 3 developed to make a determination of whether the cost of debt reflects the effects of inflation, and
 4 therefore Decision No. 70441 did not adopt an inflation adjustment to the cost of debt.

5
 6 The Company has appealed Decision No. 70441, and in this proceeding, continues to
 7 advocate applying the WACC directly to its FVRB, without any inflation adjustment, in order to
 8 calculate the Company's authorized operating income.²³³ RUCO advocates using the same
 9 methodology in this case as that used in Decision No. 70441 to reach a FVROR, by deducting a
 10 general inflation component from the cost of equity in order to avoid double-counting inflation
 11 ("Method 1").²³⁴ Staff's FVROR proposal in this case is based on the FVROR formula used in
 12 Decision No. 70441, but with a change to the application of the inflation adjustment. Staff's
 13 methodology removes the inflation component from both the cost of equity and the cost of debt to
 14 determine a FVROR ("Method 2"). Staff states that Method 1 remains a viable alternative for
 15 computing the FVROR,²³⁵ but that Method 2 benefits a utility by providing higher returns when
 16 utility property appreciates at a rate exceeding the additional return required by investors due to
 17 inflation.²³⁶

18 The Company argues that application of the unadjusted WACC to FVRB is necessary to
 19 allow the utility to earn a fair return on the current value of its property.²³⁷ CCWC charges that the
 20 recommendations of Staff and RUCO are predicated on the view that the rate of return must be
 21 reduced if the fair value of the utility's plant is used as its rate base, and that their FVROR
 22 approaches are "intended to deprive Chaparral City of the benefit of the increase in value of its
 23

24 ²³² Decision No. 70441 at 41.

25 ²³³ Company COC Brief at 27. The Company continues to argue issues previously decided in Decision No. 70441, and
 26 some of those issues are discussed herein. The fact that this Decision does not again address some of the arguments re-
 27 proffered by the Company in this case, such as, for example, its arguments regarding market-based rate base and market-
 28 derived return, does not change our analysis and determination thereon as set forth in Decision No. 70441.

²³⁴ RUCO COC Brief at 10, RUCO COC Reply Brief at 10.

²³⁵ Staff COC Brief at 5.

²³⁶ *Id.*

²³⁷ Company COC Brief at 14.

1 property.”²³⁸ CCWC continues to argue that the WACC can be directly applied to FVRB because the
 2 WACC is a function of the ratio of debt in its capital structure, and does not depend on either the
 3 amount of invested capital or the size of the rate base used to set rates, and that a market-derived rate
 4 of return can appropriately be applied to a market-based rate base.²³⁹ The Company also argues that
 5 application of the unadjusted WACC to FVRB is appropriate because the rate of return is not related
 6 to rate base, and because the inputs used to develop the WACC have no relationship to the type of
 7 rate base to which the WACC is applied.²⁴⁰ CCWC argues that FVRB is not the “inflated” cost of its
 8 plant, but is the average of its OCRB and RCND,²⁴¹ and contends that the downward adjustment to
 9 the WACC as recommended by RUCO and Staff to determine a FVROR “undermines the use of fair
 10 value.”²⁴²

11
 12 We agree with the Company that there has been no dispute in this case that FVRB is the
 13 average of CCWC’s OCRB and RCND. We disagree with the Company, however, that the FVROR
 14 methodologies proposed by RUCO and Staff “undermine” the use of fair value, or “deprive Chaparral
 15 City of the benefit of the increase in value of its property.” There are many methods the Commission
 16 can use to determine an appropriate FVROR, and as we found in Decision No. 70441, one of those
 17 methods is adjusting the WACC to exclude the effect of inflation. RUCO and Staff’s
 18 recommendations both adjust the WACC to exclude the effect of inflation in order to calculate a
 19 FVROR for the Company. CCWC claims that Staff and RUCO have focused on the effect of
 20 inflation on the cost of capital, but have ignored its effect on rate base, that neither provided a study
 21 or analysis of the impact of inflation on the Company’s rate base.²⁴³ CCWC contends that utilizing
 22 an inflation adjustment to reach a FVROR incorrectly assumes that general inflation in the economy
 23 affects both rate base and the cost of capital in the same way.²⁴⁴ We disagree. The FVROR analyses
 24 provided by RUCO and Staff focused on the inflation component contained in cost of capital. The

25 ²³⁸ Company COC Brief at 26, 27.

26 ²³⁹ *Id.* at 20, 22-23.

27 ²⁴⁰ *Id.* at 16, 21.

28 ²⁴¹ *Id.* at 3.

²⁴² *Id.* at 57.

²⁴³ *Id.* at 60-64.

²⁴⁴ *Id.*

1 effect of inflation on rate base is separately calculated in determining the RCND, and the Company's
2 proposed method has been accepted by the Commission.

3
4 As we determined after considering all the evidence in the Remand Proceeding in Docket No.
5 W-02113A-04-0616, the FVRB, which was the average of OCRB and RCND, included an inflation
6 component.²⁴⁵ The FVRB in this case was determined in the same way as the FVRB we considered
7 in Decision No. 68176 and Decision No. 70441. The record in this proceeding contains essentially
8 the same arguments CCWC made in the Remand Proceeding and affords no basis upon which to
9 reverse our determination of fact on the issue. The Company acknowledges that the RCND is the
10 current value of its plant based on its reconstruction cost, and there is no dispute in this case that
11 FVRB is the average of OCRB and RCND. RUCO and Staff's FVROR recommendations in this
12 case both take into consideration our determination in Decision No. 70441 that the FVRB, which is
13 the average of OCRB and RCND, includes an inflation component. The Company provided no study
14 or other evidence that controverts the existence of an inflation component in RCND rate base. We
15 note that the Company used the Handy-Whitman Index and the Consumer Price Index to trend its
16 OCRB to a RCND value.²⁴⁶ Both of these indices are measures of inflation. Clearly, the RCND
17 value proposed by the Company includes inflation, and that inflation component carries into the
18 FVRB.

19 The Company's proposal in this case to determine a rate of return by applying the WACC
20 directly to a FVRB comprised of an average of OCRB and RCND does not include an adjustment to
21 account for inflation. CCWC contends that the fact that application of the WACC to FVRB may
22 produce return dollars greater or less than would be produced using the "prudent investment"
23 approach is irrelevant, because fair value ratemaking is intended to recognize increases (and
24 decreases) in property values.²⁴⁷ The Company continues its argument from the Remand Proceeding
25 that *Duke Power*²⁴⁸ supports its position on FVROR,²⁴⁹ because the *Duke Power* court determined

26 ²⁴⁵ Decision No. 70441 at 41, Findings of Fact No. 14.

27 ²⁴⁶ Direct Testimony of Thomas J. Bourassa (Exh. A-3) at 7-8; Decision No. 70441 at 31-32.

28 ²⁴⁷ Company COC Brief at 14.

²⁴⁸ *State ex rel. Utilities Comm'n v. Duke Power Company*, 206 S.E.2d 269 (N.C. 1974).

²⁴⁹ Company COC Brief at 25-26.

1 that North Carolina's ratemaking statutes required the North Carolina Utilities Commission to treat
 2 the difference between the OCRB and the FVRB as equity.²⁵⁰ Staff points out that in North Carolina,
 3 the state's police power regarding ratemaking resides with the legislature, in contrast to Arizona,
 4 where the Arizona Constitution places Arizona's ratemaking authority exclusively with this
 5 Commission, and that *Duke Power* involved interpretation of a statute governing the treatment of
 6 FVRB.²⁵¹ As noted in Decision No. 70441, the Company's reliance on *Duke Power* is misplaced,
 7 because the North Carolina Supreme Court indicated that the North Carolina Commission could
 8 consider the effect of inflation in computing the cost of capital, and remanded that case to the North
 9 Carolina Commission because the fair rate of return determination had been made "through a
 10 misunderstanding" of another decision by the North Carolina Supreme Court.²⁵² The Company also
 11 continues to argue in this case that the Illinois case *City of Alton*²⁵³ supports its position.²⁵⁴ As
 12 Decision No. 70441 states, the methods addressed in that case are not helpful in setting rates in
 13 Arizona, as they seem to be after the fact, "fall-out numbers" determinations.²⁵⁵ CCWC has not
 14 presented any legal arguments that convince us to change our determination made in Decision No.
 15 70441.

16 Staff and RUCO are in agreement that, as Decision No. 68176 and Decision No. 70441 have
 17 already found, the Company's proposal to adopt the WACC as the FVROR and apply it to the FVRB
 18 would produce excessive returns.²⁵⁶ RUCO takes issue with the Company's assertion²⁵⁷ that the
 19 WACC is the fair rate of return regardless of the rate base to which it is applied.²⁵⁸ RUCO argues
 20 that an appropriate rate of return is one that compensates, but does not overcompensate, the Company
 21 for its costs.²⁵⁹ RUCO states that Decision No. 70441 determined that the double counting of
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24 ²⁵⁰ *State ex rel. Utilities Comm'n v. Duke Power Company*, 206 S.E.2d 269 (N.C. 1974).

25 ²⁵¹ Staff COC Reply Brief at 5-6.

26 ²⁵² Decision No. 70441 at 24-25.

27 ²⁵³ *City of Alton v. Commerce Comm'n*, 165 N.E.2d 513 (Ill. 1960).

28 ²⁵⁴ Company COC Brief at 23-26.

²⁵⁵ Staff COC Reply Brief at 6, citing Decision No. 70441 at 25-26.

²⁵⁶ Staff COC Reply Brief at 4, RUCO COC Reply Brief at 10.

²⁵⁷ Company COC Brief at 20-24.

²⁵⁸ RUCO COC Reply Brief at 9.

²⁵⁹ *Id.*

1 inflation in rate base and the rate of return would unfairly overcompensate investors,²⁶⁰ and Staff
2 contends that rates producing an excessive return would be neither just nor reasonable.²⁶¹ In response
3 to the Company's assertion that the results of the Remand Proceeding are "anomalous,"²⁶² Staff
4 responds that this Commission, in the Remand Proceeding resulting in Decision No. 70441, was
5 completely within its constitutional authority to craft a FVROR methodology that removed the effects
6 of inflation.²⁶³

7
8 The Company's extensive arguments on brief in this case repeat the arguments made in the
9 Remand Proceeding, and provide no basis for a deviation from our finding in those Decisions that
10 applying WACC to the FVRB would inappropriately allow inflation to be reflected in both the
11 WACC and in the FVRB, thus overstating inflation.²⁶⁴ The Company is correct that fair value
12 ratemaking recognizes increases or decreases in property values, which in this case is accomplished
13 through the use of a FVRB that includes an RCND component. In addition, fair value ratemaking
14 also recognizes the need for a fair return on the fair value of utility property. The Company's
15 proposal must be rejected, because a rate of return reached by applying the WACC directly to its
16 FVRB which includes inflation would overcompensate for inflation, and would produce an excessive
17 return on FVRB, thereby resulting in rates and charges that would be excessive, and therefore not just
18 and reasonable.

19 In order to calculate the inflation factor in the WACC, both Staff and RUCO's methods
20 subtracted the yields on Treasury inflation protected securities ("TIPS") from the yields on Treasury
21 securities with constant maturities. Staff used the 2.4 percent difference between the spot yields on a
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23 _____
²⁶⁰ RUCO COC Brief at 10, RUCO COC Reply Brief at 10.

24 ²⁶¹ Staff COC Reply Brief at 4.

25 ²⁶² Company COC Brief at 6.

26 ²⁶³ Staff COC Reply Brief at 4.

27 ²⁶⁴ See Decision No. 70441 at 36.

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1 20-year Treasury and a 20-year TIPS as a proxy for expected inflation.²⁶⁵ Because one half of the
 2 FVRB includes OCRB, which does not include inflation, Staff adjusted the 2.4 percent inflation
 3 factor by one-half, resulting in an inflation adjustment to the WACC of 1.2 percent.²⁶⁶ RUCO used
 4 historic average Treasury yields for the period 2001 through the first half of 2008 to reach its
 5 inflation estimate and deducted 200 basis points from its unadjusted cost of equity to derive the return
 6 that RUCO recommends be applied to the Company's FVRB.²⁶⁷

7
 8 The Company disagrees with RUCO's 200 basis point inflation adjustment.²⁶⁸ CCWC argues
 9 that any inflation adjustment should be reduced by one-half to account for the fact that one-half of the
 10 FVRB is comprised of plant valued at its historic cost, and that if an inflation adjustment is found
 11 appropriate in this case, the adjustment should not exceed 100 basis points.²⁶⁹ The Company
 12 contends that Staff's methodology is more appropriate than RUCO's, arguing that because RUCO's
 13 inflation adjustment is based on historical information, it is not a good proxy for any future inflation
 14 contained in investors' expected equity returns.²⁷⁰ While the Company finds Staff's methodology
 15 preferable, it disagrees with Staff's inputs, and argues that Staff should have used 5-year Treasuries
 16 instead of 20-year Treasuries, and that Staff failed to update its estimate to take into account current
 17 inflationary expectations.²⁷¹ At the hearing on January 9, 2009, Staff's witness Mr. Parcell testified
 18 that during the current economic climate, economists' opinions of projected inflation would be a

19
 20 ²⁶⁵ Staff calculated its inflation adjustment as follows:

20-year Treasury Yield (as of 8/6/08)	4.7%
less: 20-year Treasury Real Yield (as of 8/6/08)	<u>2.3%</u>
Return required by investors due to inflation*	2.4%
Times a 50% factor (to account for lack of inflation in OCRB)	0.5
Inflation adjustment	1.2%

* Staff's Final Schedule PMC-2 showed 2.5%, presumably due to rounding, which is corrected here to 2.4%.

24 Staff Final Schedule PMC-2; Direct Testimony of Staff witness Pedro M. Chaves adopted by Staff witness David C.
 25 Parcell (Exh. S-8) at 36-37; Direct Testimony of Staff witness Gordon L. Fox (Exh. S-5) at 4-11.

26 ²⁶⁶ *Id.*

27 ²⁶⁷ RUCO Final Schedule TJC-36; Direct Testimony of RUCO witness William A. Rigsby (Exh. R-14) at 62.

28 ²⁶⁸ Company COC Reply Brief at 24.

²⁶⁹ *Id.*

²⁷⁰ Company COC Brief at 62.

²⁷¹ *Id.*

1 much better indicator of expected inflation, and stated that in recent testimony, he had found that the
2 consensus forecast for inflation was 2 to 2.5 percent.²⁷² Mr. Parcell's testimony corroborates and
3 validates Staff's earlier 2.4 percent estimate, obtained using the Treasury yields as of August 6, 2008.

4
5 CCWC disagrees with Staff's Method 2 for calculating the FVROR. CCWC argues that it is
6 improper to apply an inflation adjustment to both the debt and equity portions of the Company's
7 capital structure, and that Method 2 erroneously treats the cost of its long-term debt as if it increases
8 or decreases based on current market conditions.²⁷³ CCWC argues that because its cost of debt is
9 determined based not on current market debt costs, but on its pre-existing, embedded cost of debt,
10 which does not increase or decrease in response to future inflation or other economic conditions,
11 Method 2 should be rejected.²⁷⁴ CCWC is correct that its cost of debt is determined based not on
12 current market debt costs, but on its pre-existing, embedded cost of debt, which does not increase or
13 decrease in response to future inflation or other economic conditions. However, as CCWC itself
14 acknowledges, inflation is a component of the cost of debt. The Company states in a footnote that
15 "[i]n some cases, there may be a secondary market for bonds, notes and other debt instruments. The
16 price that a purchaser is willing to pay for a particular debt instrument is affected by a number of
17 different factors, including expected inflation."²⁷⁵ The Company's footnote goes on to state that
18 despite the existence of secondary markets, "the borrower's obligation to pay interest in accordance
19 with the terms of the debt instrument is unaffected by such secondary sales and remains fixed."²⁷⁶
20 While this is true, it does not change the fact that debt includes an inflation component. The cost of
21 debt includes the investors' expectations regarding inflation, and, as Staff explains, a change in
22 purchase price of debt instruments on the secondary market reflects the change in debt cost that the
23 investor requires due to inflation.²⁷⁷ While the Company is correct that the inflation component

24 ²⁷² Tr. at 748-749. Mr. Parcell's testimony was in response to a Federal Reserve Statistical Release ("FRSR") dated
25 January 7, 2009, which the Company introduced at the hearing (Exh. A-17). Mr. Parcell testified that in normal times,
26 looking at the differential between long-term Treasury bonds and long-term interest rate swaps using the same maturity
27 may be a reasonable way to develop a proxy for inflation, but that in the current economic environment using the
28 differential is problematic because both instruments have been driven to such low levels.

²⁷³ Company COC Brief at 67, 69.

²⁷⁴ *Id.*

²⁷⁵ Company COC Brief at 68, fn 279.

²⁷⁶ *Id.*

²⁷⁷ Staff COC Reply Brief at 8.

1 embedded in its existing debt does not change unless it is refinanced, the inflation component is
2 nonetheless there, and the Company failed to provide an estimate of that inflation component
3 embedded its existing debt. Accordingly, the best evidence available on the record is Staff's. Staff's
4 proposed Method 2 applies the inflationary adjustment to the entire cost of capital, including equity
5 and debt, in recognition of the fact, demonstrated in the record in this case,²⁷⁸ that inflation is a
6 component of debt as well as equity.

7
8 The Company contends that RUCO's proposed rate of return of 6.38 percent is too low and
9 attempts to support its position by comparing it to the 9 percent interest rate on investment grade
10 (Baa) bonds.²⁷⁹ RUCO argues in response that the Company's reliance on a FRSR showing the
11 interest rate on investment grade bonds at 9 percent is misplaced because the FRSR does not
12 distinguish the rates of return for utilities bonds from other corporate bonds.²⁸⁰ RUCO believes that
13 the Company's rate of return comparison should be based on the returns of regulated utilities as
14 opposed to the returns of other corporations, and recommends that the Commission consider, instead
15 of the January 7, 2009, FRSR,²⁸¹ the January 9, 2009 Value Line Investment Survey,²⁸² which
16 contains statistical analysis of corporate bond yields, but distinguishes yields on utility bonds from
17 yields on other corporate bonds, and shows the return on corporate utility bonds for 25-30 year grade
18 Baa/BBB to be 6.58 percent.²⁸³ Our FVROR determination in this proceeding is not based on any
19 comparable earnings analysis, but on the market-based analyses performed by the parties. However,
20 we note that the Company's argument that a 6.38 percent FVROR is too low because the interest rate
21 on investment grade (Baa) bonds is 9 percent is not convincing, and that RUCO is correct that if such
22 a comparison were to be made, it would be more appropriate to compare the recommended rates of
23 return to yields on utility bonds rather than on the FRSR produced by the Company at the hearing.

24
25
26 ²⁷⁸ See, e.g., Direct Testimony of Staff witness Gordon L. Fox (Exh. S-5) at 5-7.

27 ²⁷⁹ See Exh. A-17, FRSR dated January 7, 2009.

28 ²⁸⁰ RUCO COC Brief at 10.

²⁸¹ Exh. A-17.

²⁸² Exh. R-16.

²⁸³ RUCO COC Brief at 10.

1 The Company again asserts that if adjustments are made to components of the WACC to
 2 account for inflation, inflation must also be considered in relation to operating expenses,²⁸⁴ and
 3 contends that the normalization of test year operating expenses using expense levels from 2004 and
 4 2005 as recommended by RUCO and Staff ignores inflationary effects.²⁸⁵ The Company argues that
 5 considering the impact of inflation only on the cost of capital ignores the impact of inflation on the
 6 Company's overall earnings, and argues that adjusting cost of equity estimates to account for
 7 inflation in determining the rate of return while ignoring the impact of inflation on the Company's
 8 overall cost of providing service amounts to "piecemeal regulation."²⁸⁶ The Company contends that
 9 if an inflation adjustment is used to determine its rate of return, an upward adjustment using the same
 10 percentage should be made to its test year operating expenses, in order to account for the impact of
 11 inflation during 2007 and 2008, and during the time rates will be in effect.²⁸⁷ The "matching"
 12 adjustment to operating expenses proposed by the Company is unsupported by the evidence and
 13 inappropriate. We disagree with the Company's assertion that adjusting the WACC to arrive at a
 14 FVROR "ignores the impact of inflation on the Company's overall earnings," or amounts to
 15 "piecemeal regulation." As Staff explains, an adjustment to the WACC to arrive at the FVROR is not
 16 an adjustment to reflect matching, but is necessary to avoid double counting of inflation that is found
 17 in the RCND rate base and in the cost of capital.²⁸⁸ As we noted in Decision No. 70441, removing
 18 inflation from the return no more amounts to "piecemeal regulation" than does adding inflation to the
 19 rate base.²⁸⁹ In contrast to FVROR, which is forward-looking, operating expenses are matched with
 20 associated revenues.²⁹⁰ Inflation in operating expenses is already inherently recognized in the
 21 ratemaking framework, which encourages utilities to seek operating efficiencies²⁹¹ and allows
 22 modifications to test year expenses based on known and measurable changes in costs during the test
 23
 24

25 ²⁸⁴ Company COC Brief at 3-4.

26 ²⁸⁵ *Id.*

27 ²⁸⁶ *Id.*

28 ²⁸⁷ *Id.*

²⁸⁸ Staff COC Brief at 4, citing Tr. at 461.

²⁸⁹ Decision No. 70441 at 32.

²⁹⁰ Tr. at 461.

²⁹¹ Tr. at 461.

1 year. There is no basis in the record to support the Company's proposed inflationary adjustment to
2 operating expenses.

3
4 The rate of return applied to a utility's FVRB is designed to (1) allow the utility to attract
5 capital on reasonable terms; (2) maintain the utility's financial integrity; and (3) permit the utility to
6 realize a return that is commensurate with the returns earned by enterprises with commensurate risks.
7 CCWC states that in setting its rate of return, this Commission must take into account the risks
8 associated with the particular rate-setting methodologies used in Arizona and their impact on the
9 Company's ability to earn a reasonable return on the fair value of its utility plant used to provide
10 service.²⁹² CCWC contends that a lack of adjustment mechanisms and inability to obtain rate relief
11 outside a general rate case create additional business risk and requires a "higher return on equity,"²⁹³
12 and that the regulatory lag related to Arizona's use of a historic test year impacts the Company's
13 ability to earn a reasonable return.²⁹⁴ The Company states that operating expenses reflected in its
14 current rates are based on the 12-month period ended December 31, 2003, and that it is not currently
15 earning a return on the increased value of its plant since its rates were set in Decision No. 68176, or
16 on plant constructed and placed in service since December 31, 2003.²⁹⁵ The Company complains that
17 when rates are set in this case, they will be based on operating expenses for the year ended December
18 31, 2006, and will not provide the Company with a return on plant constructed and placed in service
19 after December 31, 2006.²⁹⁶ The Company's argument ignores the fact that in this case, we are
20 allowing \$1.28 million in post-test year plant to be included in rate base. The issues the Company
21 raises here related to the regulatory lag and Arizona's constitutional constraints affecting the
22 ratemaking process are issues that apply to all Arizona utilities, and not just CCWC. As RUCO
23 acknowledges, the fundamental premise of the return on rate base ratemaking approach is to allow
24 utilities an opportunity to recover their actual costs, including their actual cost of capital, consistent
25 with competitive industries.²⁹⁷ Applying the WACC directly to a utility's FVRB when the WACC

26 ²⁹² *Id.*

27 ²⁹³ *Id.* at 19.

28 ²⁹⁴ *Id.* at 19-20.

²⁹⁵ *Id.* at 65.

²⁹⁶ *Id.*

²⁹⁷ RUCO COC Reply Brief at 9.

1 includes an inflation component would not accomplish this ratemaking goal. As Staff contends, the
 2 Company is advocating for a rate of return methodology which would produce comparably higher
 3 rates, which conflicts with the most basic tenet of rate regulation, which is that a utility should be
 4 provided with rates that will allow it an opportunity to earn a return that is comparable to those of
 5 similarly situated enterprises.²⁹⁸ We addressed these arguments in Decision No. 70441, and nothing
 6 presented in this case causes us to change our determination therein.

7
 8 In determining an appropriate and equitable level for the FVROR in this case, we are mindful
 9 of the need for the Company to have the ability to attract capital and obtain a fair return, and we are
 10 also mindful of the need to take into account the interests of the ratepayers. As we found in Decision
 11 No. 68176 and Decision No. 70441, using the Company's proposed methodology would produce
 12 excessive returns, and it must therefore be rejected. Because there is an inflation component in the
 13 Company's FVRB, all inflation must be removed from the rate of return, whether in debt or equity.
 14 While further refinements to methodologies to accomplish this necessity may be possible, and are
 15 encouraged, we find that Staff's Method 2 appropriately matches an inflation-free rate of return to
 16 FVRB. The Method 2 recommendation of Staff to apply an inflation adjustment to both the equity
 17 and debt components of the WACC is a reasoned and sound approach to determining a FVROR that
 18 equitably balances the needs of the Company and its ratepayers, and results in the setting of just and
 19 reasonable rates. We therefore adopt a FVROR of 7.52 percent in this case.

20 **E. Fair Value Rate of Return Summary**

21	Weighted Average Cost of Capital	8.72%
22	Inflation Adjustment	<u>-1.20%</u>
23	Fair Value Rate of Return	7.52%

24 **VII. AUTHORIZED INCREASE**

25 Based on our findings herein, we determine that the Company's gross revenue should increase
 26 by \$1,896,281.
 27 ...
 28 ...

²⁹⁸ Staff COC Reply Brief at 5, citing *Federal Power Comm'n v. Hope Natural Gas*, 320 U.S. 591, 64 S.Ct. 281 (1944).

1	Fair Value Rate Base	\$27,620,414
	Adjusted Operating Income	926,627
2	Required Fair Value Rate of Return	7.52%
	Required Operating Income	\$ 2,077,055
3	Operating Income Deficiency	1,150,428
	Gross Revenue Conversion Factor	1.6483
4	Gross Revenue Increase	\$ 1,896,281

VIII. RATE DESIGN

A. Irrigation and Construction Rates

7 The Company is proposing the same rate design approved in Decision No. 68176, with the
8 exception of increasing the commodity rate for Irrigation and Construction water. Zero gallons are
9 included in the monthly minimum charge, and the commodity rate has three inverted tier blocks, with
10 the first breakover point at 3,000 gallons, and the second breakover point at 9,000 gallons. In order
11 to eliminate the disparity in the current rate design between Irrigation and Construction water
12 customers and other customers, and to promote water conservation,²⁹⁹ the Company proposes to
13 charge Irrigation and Construction water customers the same monthly minimum charges as other
14 customers according to meter size, with a single Irrigation and Construction commodity rate equal to
15 the first tier commodity charge for commercial and industrial customers, for all usage. Staff proposes
16 a rate design similar to the Company's for Irrigation and Construction water.³⁰⁰ Currently, the
17 Irrigation Service commodity charge is a flat \$1.56 per 1,000 gallons, which is lower than the first
18 tier commodity rate for 3/4-inch metered residential customers. The Company believes that from a
19 water conservation standpoint, customers using potable water for irrigating turf and landscaping
20 should be charged more.³⁰¹ Under the rates proposed by the Company, RUCO, and Staff in their
21 final schedules, the commodity charge would increase to \$3.34, \$2.65, and \$2.95, respectively, with
22 the differences being due to differing recommended revenue requirements. Staff states that the
23 purpose of its proposal is to move the rates for Irrigation and Construction water closer to the
24 commodity rates paid by other customers, and that it believes the approach will help in promoting
25 water conservation.³⁰²

26
27 ²⁹⁹ Company Brief at 25.
³⁰⁰ Staff Final Schedule MEM-27.
³⁰¹ Company Brief at 25.
28 ³⁰² Staff Brief at 12-13; Staff Reply Brief at 6.

1 Pacific Life argues that the Company's proposed increase for Irrigation and Construction
 2 water customers was not properly noticed.³⁰³ Staff states that CCWC published notice in compliance
 3 with the rate case procedural order issued in this case, and that Pacific Life filed for intervention on
 4 September 15, 2008, which was granted on September 26, 2008. Staff notes that Pacific Life did not
 5 raise any issues regarding notice once it was granted intervenor status, or during the time leading up
 6 to the date for filing direct testimony.³⁰⁴ As Staff notes, Pacific Life did not file direct testimony or
 7 actively participate during the evidentiary hearings.³⁰⁵ The Company points out that, as Pacific Life
 8 discusses in its brief, a discussion of the increases in specific rates for specific customer classes was
 9 set forth in the Company's filing in the direct testimony of its accounting witness,³⁰⁶ and that the
 10 direct testimony of the Company's witness Mr. Hanford also addressed the Company's requested
 11 change in the irrigation rate. Those direct testimonies were filed with the Company's application,
 12 and the published notice directed interested parties how to view a copy of the application. The
 13 notice, which was published on August 6 and August 13, 2008, also specifically stated that "[t]he
 14 actual percentage rate increase for individual customers would vary depending on the type and
 15 quantity of service provided. You may contact Chaparral City to determine what the effect of its rate
 16 proposal may be on your individual bill." The record in this proceeding reflects the fact that while
 17 Pacific Life may have chosen not to take advantage of its procedural opportunities to present a case
 18 and cross examine witnesses in this proceeding, the opportunity was available to it, and Pacific Life
 19 was not procedurally disadvantaged.

20 Pacific Life argues that the Company's proposed increase for Irrigation and Construction
 21 water customers could be detrimental to golf course and residential users.³⁰⁷ The Company contends
 22 that this claim by Pacific Life on brief is unsupported by any evidence on record in this case, and that
 23 the two possible explanations for the lack of evidence are (1) the evidence does not exist; or (2)
 24 Pacific Life failed to avail itself of the opportunity to present evidence.³⁰⁸ Staff states that it is
 25

26 ³⁰³ Pacific Life Brief at 1-4.

27 ³⁰⁴ Staff Reply Brief at 9-10.

28 ³⁰⁵ *Id.* at 10.

³⁰⁶ Company Reply Brief at 19.

³⁰⁷ Pacific Life Brief at 4-6.

³⁰⁸ Company Reply Brief at 20.

1 concerned about the effect a rate increase will have on all customers, including irrigation customers,
 2 and that in making its recommendations, Staff must balance the interests of the Company and the
 3 interests of all customers.³⁰⁹ Staff notes that currently, irrigation customers have the lowest
 4 commodity charge, that the disparity between the commodity rates of the classes should be
 5 minimized to encourage water conservation, and that Staff believes its approach is fair and balances
 6 the interests of the Company and its customers.³¹⁰

7 Pacific Life argues that a similar proposed increase for Irrigation and Construction water
 8 customers was rejected in the Company's last rate case.³¹¹ Staff states that each case that comes
 9 before the Commission requires independent analysis and a determination based on the facts of the
 10 specific case, and therefore the fact that the Commission considered and rejected a similar increase to
 11 irrigation customers in a prior case is not binding on a determination in this case.³¹² The Company
 12 also argues that Decision No. 68176 is not dispositive on the issue, and that Pacific Life offers no
 13 reason that the Company could not again raise the issue in this rate case for Commission
 14 consideration based on fair treatment of all its customers and to promote conservation.³¹³

15 Pacific Life argues that without a cost-of-service study, there is no evidentiary basis to
 16 increase rates for one class of customers more than for another customer class.³¹⁴ The Company
 17 disagrees, stating that it is not requesting a change to its rate design in this case, but is seeking to
 18 address what appeared to be an anomaly in its rate design, given the Commission's decision to adopt
 19 Staff's proposed inverted tier rate design in the last rate case for the purpose of promoting
 20 conservation.³¹⁵ The Company contends that Pacific Life's assertions concerning the need for a cost
 21 of service study are unsupported and irrelevant, because the Company's current rate design is not
 22 based on a cost of service study. Staff contends that because the Company's proposed rate design is
 23 not different than the one approved in its last rate case, a cost of service study is not required.³¹⁶

24 _____
 25 ³⁰⁹ Staff Reply Brief at 11.

³¹⁰ *Id.*

26 ³¹¹ Pacific Life Brief at 6.

³¹² *Id.*

27 ³¹³ Company Reply Brief at 21.

³¹⁴ Pacific Life Reply Brief at 1-3.

³¹⁵ *Id.*

28 ³¹⁶ *Id.*

1 Pacific Life argues that the Company admits that test year revenues reflect that irrigation
2 customers have already been successful in conserving water, and that “[t]here is no evidence that
3 further conservation is needed, or even wise.”³¹⁷ The Company states that it is proposing to raise the
4 rate structure for Irrigation and Construction water because the current rate design is inconsistent
5 with and contrary to the premise of the inverted tier rate design adopted in Decision No. 68176 to
6 promote water conservation.³¹⁸ The Company believes the Commission should consider whether it is
7 appropriate to impose inverted tier rates on residential and commercial customers, while allowing
8 Irrigation and Construction water customers to purchase potable water for landscape irrigation at a
9 rate that is substantially below the first tier commodity rate applicable to other customers.³¹⁹

10 We agree with the Company that the current rates for potable irrigation water are inconsistent
11 with and contrary to the premise of the inverted tier rate design adopted in Decision No. 68176 to
12 promote water conservation. The disparity between the commodity rate for Irrigation and
13 Construction water customers and other customers needs to be addressed, and the rate designs
14 proposed by the parties fairly address the issue. While we are cognizant of the fact that bringing the
15 Irrigation and Construction commodity rates closer to those for other customers will affect golf
16 courses and other customers who purchase potable water for turf and landscape purposes and
17 construction, we find that a correction to the rate design approved in Decision No. 68176 is in order.
18 We will adopt the parties’ proposals to charge Irrigation and Construction water customers the
19 monthly minimum charges by meter size and a flat commodity rate equal to the first tier commodity
20 rate for other commercial and industrial customers.

21 **B. Low Income Tariff**

22 Staff states that the Commission has approved low income tariffs for a number of utilities, and
23 with the recent downturn in our economy, there is an even greater need for these types of tariffs.³²⁰
24 The Company has proposed a low income tariff to provide an opportunity for those customers that
25 need assistance to lower their cost of water utility service. The Company proposes that customers

26 _____
27 ³¹⁷Pacific Life Brief at 6-8; Pacific Life Reply Brief at 2.

³¹⁸ Company Reply Brief at 22.

³¹⁹ *Id.*

³²⁰ Staff Reply Br. at 13.

1 meeting the necessary qualifications would receive a 15 percent discount off their water bill.³²¹ The
 2 primary criteria would be based on the combined gross annual income of all persons living in the
 3 household. For example, a 4-person household with a total gross annual income of less than or equal
 4 to \$31,800 would meet the criteria.³²² Customers would sign up for the program by completing an
 5 application and eligibility declaration and submitting proof of income to the Company.³²³ The
 6 income guidelines are based on 150 percent of the 2008 federal poverty guidelines.³²⁴ The Company
 7 would update its gross annual household income limits annually.³²⁵

8 The program costs (the discounts given to participants plus a 10 percent fee for administration
 9 and carrying costs) would be recovered from non-participants via a commodity surcharge.³²⁶ The
 10 Company would maintain a balancing account to keep track of the program costs and the collections
 11 made from non-participants, and the commodity surcharge to non-participants would begin one year
 12 after the program begins.³²⁷ CCWC will track the program costs for 12 months, and upon completion
 13 of the 12 month period, the Company will compute a surcharge intended to collect the prior year's
 14 program costs over the next 12 months.³²⁸ CCWC would submit an annual report to the Commission
 15 showing the number of participants for the year, the discounts given to participants, administration
 16 fee and carrying costs, and the collection made from non-participants through the surcharge.³²⁹
 17 Based on the existing bill for median usage on a 3/4-inch meter currently at \$24.94, the low income
 18 program would result in a reduction of \$3.74.³³⁰ The surcharge impact for non-participants, based on
 19 the 2006 gallons sold, would be about 4 cents on the average 3/4-inch customer bill.³³¹

20 Staff recommends that the Company's low income tariff proposal be adopted.³³² Staff's
 21 recommendation is reasonable and will be adopted. We will direct the Company to file, along with
 22

23 ³²¹ Supplemental Rebuttal Testimony of Company witness Thomas J. Bourassa (Exh. A-6) at 2.

24 ³²² *Id.*

25 ³²³ *Id.*

26 ³²⁴ *Id.*

27 ³²⁵ *Id.* at 3.

28 ³²⁶ *Id.*

³²⁷ *Id.*

³²⁸ *Id.*

³²⁹ *Id.* at 4.

³³⁰ *Id.* at 5.

³³¹ *Id.* at 6.

³³² Staff Brief at 14.

1 the tariff of rates and charges approved herein, a copy of the Low Income Tariff it provided with its
 2 brief and reproduced and attached hereto as Exhibit A, and to implement the Low Income Tariff as
 3 described in the Supplemental Rebuttal Testimony of Company witness Thomas J. Bourassa (Exh. A-
 4 6).

5 C. Delay Surcharge Request

6 The Company proposes on brief that a “surcharge for delay” should be imposed on its
 7 customers to allow it to recover revenue increases it did not recover during the six-month stay of
 8 proceedings in this case granted at Staff’s request pending the outcome of the Remand Proceeding.³³³
 9 The Company requests that the surcharge include “appropriate carrying costs.”³³⁴ The Company
 10 contends that it should be compensated both for that delay and for the additional delay caused by
 11 Staff’s decision to bring in an outside consultant three days prior to the hearing, and the subsequent
 12 bifurcation of the hearing to hear cost of capital issues separately from the other issues.³³⁵

13 Staff responds that while there were delays in this case, CCWC has not demonstrated, other
 14 than by the assertions made on brief, any harm that should be ameliorated.³³⁶ Staff contends that
 15 delays can be common in rate cases where the issues are complex, and that the Company’s ratepayers
 16 should not bear the burden of the delays.³³⁷ Staff argues that the surcharge proposed by the Company
 17 is not supported by the record and it should therefore be rejected.³³⁸

18 After the parties made their arguments on the appropriateness of Staff’s requested suspension
 19 of the Commission’s Time Clock Rule³³⁹ in this matter, a Procedural Order was issued in this case on
 20 January 22, 2008. The January 22, 2008, Procedural Order outlined the parties’ positions and the
 21 consideration of the issue, and ultimately found that the timing of this rate case, in conjunction with
 22 the uncommon nature, and the timing, of the Remand Proceeding that was pending at the time,
 23 constituted an extraordinary circumstance, pursuant to A.A.C. R14-2-103(B)(11)(e)(ii), requiring
 24 suspension of the Timeclock Rule. The January 22, 2008, Procedural Order called for the hearing to

25 ³³³ Company Brief at 26-27.

26 ³³⁴ *Id.*

27 ³³⁵ *Id.*

28 ³³⁶ Staff Reply Brief at 6.

³³⁷ *Id.*

³³⁸ *Id.*

³³⁹ A.A.C. R14-2-103(B)(11).

1 continue in this proceeding as soon as practicable following the Commission's final order in the
 2 Remand Proceeding, and directed the parties to continue to conduct discovery and case preparation to
 3 the greatest extent possible during the duration of the continuance in order to minimize any delay in
 4 implementation of new rates pursuant to this application.

5 We agree with Staff that the Company has not demonstrated the "injury due to this delay" it
 6 alleges on brief. Neither has the Company quantified the extent of the alleged injury. The delay was
 7 necessary to resolve the issues in the Remand Proceeding, which directly affects this case. We agree
 8 with Staff that under the circumstances of this case, the Company's ratepayers should not be asked to
 9 bear any additional burden due to the extraordinary circumstances that led to the suspension of the
 10 Timeclock Rule in this proceeding, and will deny the Company's request.

11 * * * * *

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

14 **FINDINGS OF FACT**

- 15 1. On September 26, 2007, CCWC filed a rate increase application with the Commission
 16 based on a test year ended December 31, 2006.
- 17 2. On October 26, 2007, the Staff filed a letter finding the application sufficient and
 18 classifying CCWC as a Class A utility.
- 19 3. By Procedural Order issued November 30, 2007, a hearing was set on the application
 20 to commence on July 8, 2008, associated procedural deadlines were set, and intervention was granted
 21 to RUCO.
- 22 4. On December 7, 2007, the Company filed a Request to Modify Procedural Schedule in
 23 which the Company requested a continuation of the hearing due to a conflict on the part of counsel.
- 24 5. A telephonic procedural conference was held on December 13, 2007, for discussion of
 25 the need for an extension of the deadline for a Commission Decision in this matter pursuant to
 26 A.A.C. R14-3-103(B)(11) (the Commission's "Time Clock Rule") in conjunction with the
 27 Company's requested schedule modification.
- 28 6. An Amended Rate Case Procedural Order was issued on December 19, 2007,

1 continuing the hearing on this matter from July 8, 2008, to July 21, 2008, and continuing associated
2 procedural deadlines.

3 7. On January 3, 2008, Staff filed a Motion to Suspend Time Clock.

4 8. On January 8, 2008, CCWC filed its Response in Opposition to the Motion to Suspend
5 Time Clock.

6 9. On January 10, 2008, RUCO filed its Response to the Utilities Division's Motion to
7 Suspend Time Clock.

8 10. On January 14, 2008, Staff filed its Reply to Company's Response to Staff's Motion
9 to Suspend Time Clock.

10 11. On January 22, 2008, a Procedural Order was issued granting Staff's Motion to
11 Suspend Timeclock. The Procedural Order continued the hearing pursuant to the Time Clock Rule,
12 and ordered that the hearing would be reset to continue as soon as practicable following the
13 Commission's final order in Docket No. W-02113A-04-0616, the remand of Decision No. 68176
14 (September 30, 2005), a pending matter in which the rates of CCWC were also being considered.
15 The Procedural Order directed all parties to continue to conduct discovery and case preparation to the
16 greatest extent possible during the duration of the continuance, in order to minimize any delay in
17 implementation of new rates pursuant to the application.

18 12. On January 24, 2008, the Company filed a Motion for Reconsideration by the
19 Commission of Procedural Order Staying Rate Application.

20 13. On January 28, 2008, Staff filed Staff's Response to Chaparral City Water Company's
21 Motion for Reconsideration.

22 14. On June 30, 2008, a Recommended Opinion and Order for Commission consideration
23 was filed in Docket No. W-02113A-04-0616.

24 15. On July 7, 2008, the Company filed a Notice of Implementation of Interim Rates
25 Pursuant to A.R.S. § 40-256.

26 16. On July 8, 2008, RUCO filed its Opposition to the Company's Implementation of
27 Interim Rates and Motion to Prohibit the Company from Implementing Interim Rates.

28 17. On July 11, 2008, the Company filed a Notice of Postponement of Implementation of

1 Interim Rates Pursuant to A.R.S. § 40-256.

2 18. On July 16, 2008, Staff filed Staff's Response to the Company's Notice of
3 Implementation of Interim Rates Pursuant to A.R.S. § 40-256 and Notice of Postponement. Therein,
4 Staff stated that it would oppose an attempt by the Company to notice and implement a rate increase
5 without an order by the Commission. Staff included legal arguments in support of its position, and
6 requested that a procedural conference be scheduled to address the issues raised by the Company's
7 notices regarding interim rates.

8 19. On July 17, 2008, at an Open Meeting of the Commission, the Commission voted to
9 adopt, as amended, the Recommended Opinion and Order filed in Docket No. W-02113A-04-0616
10 on June 30, 2008. The Commission subsequently issued Decision No. 70441 (July 28, 2008) in that
11 docket.

12 20. On July 18, 2008, a procedural order was issued setting a procedural conference for
13 the purpose of allowing the parties to discuss an appropriate procedural schedule, including the
14 resetting of a hearing date so that the case could proceed as quickly as possible, and to discuss the
15 Company's filings regarding the implementation of interim rates.

16 21. On July 21, 2008, the Procedural Conference was convened as scheduled. Counsel for
17 the Company, RUCO and Staff appeared and discussed procedural deadlines for the filing of Staff
18 and intervenor direct testimony and also briefly discussed their positions regarding the Company's
19 filings regarding implementation of interim rates. Counsel for RUCO withdrew its Motion to
20 Prohibit the Company from Implementing Interim Rates.

21 22. On July 24, 2008, a Second Amended Rate Case Procedural Order was issued,
22 continuing the hearing date to commence on December 8, 2008.

23 23. On September 4, 2008, the Company filed its Certification of Publication and Proof of
24 Mailing, indicating that it provided notice of the hearing as required.

25 24. On September 8, 2008, the Company submitted a Notice of Filing requesting, as
26 authorized in Decision No. 70441, recovery of the Company's rate case expense in connection with
27 the appeal and remand of Decision No. 68176.

28 25. Also on September 8, 2008, the Company filed a Motion for Approval of Interim

1 Rates (Expedited Action Requested).

2 26. On September 12, 2008, the Company filed a Request for Procedural Conference.

3 27. On September 23, 2008, Staff filed its Response to the Company's Motion for
4 Approval of Interim Rates.

5 28. On September 23, 2008, RUCO filed its Opposition to the Company's Motion for
6 Interim Rates.

7 29. On September 26, 2008, by procedural order, Pacific Life's September 15, 2008,
8 Motion to Intervene was granted.

9 30. On September 30, 2008, the Company filed its Reply in Support of Motion for
10 Approval of Interim Rates (Expedited Action Requested).

11 31. On September 30, 2008, a Procedural Order Extending Filing Deadlines was issued,
12 granting Staff's request to extend the deadline for Staff and intervenor direct testimony to October 3,
13 2008, and extending the deadline for intervenor surrebuttal testimony to November 20, 2008.

14 32. RUCO and Staff filed direct testimony on September 30, 2008, and October 3, 2008,
15 respectively.

16 33. On October 2, 2008, the Company filed its Second Request for Procedural
17 Conference.

18 34. On October 7, 2008, a procedural order was issued setting a procedural conference for
19 October 20, 2008, for the purpose of allowing the parties to discuss the Company's Motion for
20 Approval of Interim Rates.

21 35. A procedural conference was held as scheduled. The Company, RUCO and Staff
22 appeared through counsel. At the procedural conference, the Company stated that it wished to
23 proceed with the rate application in lieu of the alternative option of suspending the rate proceeding in
24 favor of proceeding to hearing on the Motion for Approval of Interim Rates.

25 36. On October 24, 2008, Staff filed a Notice of Filing of Meeting on Settlement, and on
26 October 28, 2008, Staff filed a Corrected Notice of Filing of Meeting on Settlement.

27 37. On October 31, 2008, the Company filed its rebuttal testimony, and filed supplemental
28 rebuttal testimony on November 19, 2008.

1 38. On November 12, 2008, Pacific Life filed a Notice of Appearance of Counsel,
2 indicating a change of counsel.

3 39. On November 20, 2008, RUCO filed surrebuttal testimony. An Errata thereto was
4 filed on November 25, 2008.

5 40. On November 20, 2008, Staff filed surrebuttal testimony of two witnesses.

6 41. On November 21, 2008, Staff filed a Notice of Witness Substitution and Request for
7 Procedural Order. Staff requested that it be allowed to file substitute witness Mr. Parcell's surrebuttal
8 testimony on cost of capital on December 3, 2008, and requested a date certain of December 15,
9 2008, for Mr. Parcell's live testimony.

10 42. On November 24, 2008, the Company filed its Response objecting to Staff's
11 November 21, 2008 filing.

12 43. On November 24, 2008, the Town of Fountain Hills filed a public comment letter
13 requesting that the Commission not approve the Company's requested rate increase.

14 44. On November 26, 2008, Staff filed a Reply to the Company.

15 45. On December 2, 2008, a Procedural Order was issued granting Staff's request to file
16 the surrebuttal testimony of its substitute witness on December 3, 2008, and indicating that the dates
17 certain requested by Staff for presentation of its expert witness were not available for hearing, but
18 that a suitable schedule for proceeding with the parties' presentation of their cases on cost of capital
19 would be discussed at the prehearing conference scheduled for December 5, 2008.

20 46. On December 3, 2008, Staff filed a Notice of Filing Surrebuttal Testimony of David
21 C. Parcell.

22 47. On December 4, 2008, the Company filed rejoinder testimony. An Errata thereto was
23 filed on December 5, 2008.

24 48. On December 5, 2008, the prehearing conference was held as scheduled. The
25 Company, RUCO and Staff appeared through counsel. Pacific Life did not enter an appearance. The
26 Company stated an objection to Staff's substitute witness Parcell's prefiled surrebuttal testimony, and
27 after discussion, Staff agreed to make a filing regarding Mr. Parcell's adoption of Staff witness
28 Chaves' testimony.

1 49. 241 written public comments were filed in opposition to the Company's requested rate
2 increase between August 20, 2008, and March 9, 2009.

3 50. On December 8, 2008, the hearing convened as scheduled. Prior to the presentation of
4 evidence, members of the public provided comments for the record. Commenters included Fountain
5 Hills Mayor Jay T. Schlum, Stephen Dausch, Marianne Wiggishoff, Richard V. Kloster, Richard
6 Baurle, Leona Johnston, Jerry Butler, Beth Mulcahy, and Ken Watkins. Commenters indicated a
7 concern that the proposed rate increase would affect homeowners in the Company's service area not
8 only by increasing individual homeowners' water bills, but also by increasing community
9 associations' water utility costs.³⁴⁰ Commenter Ken Watkins stated that he believes the Company's
10 rate proposal has an unfair effect on the Company's golf course customers.³⁴¹

11 51. The Company, RUCO and Staff appeared at the hearing through counsel. Pacific Life
12 did not appear. The Company, RUCO and Staff presented evidence and cross-examined witnesses on
13 all issues with the exception of cost of capital and rate of return. The hearing was recessed on
14 December 10, 2008, and was scheduled to reconvene on January 8 and 9, 2009, for the purpose of
15 taking evidence on the bifurcated issues of cost of capital and rate of return.

16 52. On December 9, 2008, Staff filed the portions of Pedro M. Chaves' direct testimony
17 adopted by David C. Parcell, and an Errata thereto was filed on December 15, 2008.

18 53. On December 11, 2008, Pacific Life filed a Motion for Leave to Present Testimony,
19 requesting leave to present testimony on the issue of the impact of the Company's proposed increase
20 in irrigation rates.

21 54. On December 16, 2008, the Company filed a Response to Pacific Life's Motion. The
22 Company opposed granting Pacific Life's request. The Company stated that the Motion was filed
23 substantially beyond the deadlines set for prefiled intervenor testimony, after the prehearing
24 conference, and following the completion of the hearing on all issues with the exception of the
25 bifurcated cost of capital and rate of return issues. The Company argued that Pacific Life had not
26 provided a legitimate basis for its request to file testimony at the late date, following the completion

27 _____
28 ³⁴⁰ Tr. at 6-23.

³⁴¹ Tr. at 19-23.

1 of the parties' rate design witnesses' testimony. The Company further argued that the hearing had
2 already been delayed, and that allowing the requested untimely filing of rate design testimony would
3 prejudice the Company.

4 55. On December 17, 2008, RUCO filed its Response to the Motion. Therein, RUCO
5 requested that the current witness schedule not be disrupted, and stated that if Pacific Life's
6 testimony was allowed, RUCO reserved the right to present rebuttal testimony.

7 56. On December 17, 2008, Staff filed its Response to the Motion. Therein, Staff stated
8 that it was not opposed to the filing of testimony by Pacific Life's proposed witness, but that it would
9 reserve the right to recall its witness on rate design. Staff filed an Errata to its Response on
10 December 18, 2008.

11 57. On December 17, 2008, Pacific Life filed a Reply to the Company's Response to the
12 Motion. Pacific Life contended that presentation of the testimony of its witness would not delay this
13 case, because it was not asking to reopen the record, but wished to take advantage of an additional
14 hearing day that had already been scheduled.

15 58. On December 23, 2008, the Company filed supplemental rejoinder testimony on cost
16 of capital. An Errata thereto was filed on December 30, 2008.

17 59. On December 24, 2009, a Procedural Order was issued denying Pacific Life's Motion,
18 finding that granting the Motion would require reopening the completed first segment of the
19 bifurcated hearing, resulting in a time delay and prejudice to the parties, and that Pacific Life had
20 failed to avail itself of numerous opportunities to either conform to the same procedural schedule as
21 the other parties to this case, or to request accommodation in a timely manner.

22 60. On January 5, 2009, Staff filed a Notice of Filing Regarding Investigation. The Notice
23 stated that the CPUC had contacted Staff regarding a CPUC investigation of Golden States, an
24 affiliate of CCWC. The CPUC had alerted Staff that in the course of a CPUC investigation into
25 Golden States, the CPUC had discovered information relating to CCWC that it thought would be of
26 interest to Staff. The Notice stated that Staff was working with the CPUC on a confidentiality
27 agreement that would allow Staff to obtain information from the CPUC regarding the investigation.

28 61. On January 6, 2009, Staff filed a Notice of Filing to which was attached a copy of a

1 November 15, 2007, complaint filed in Los Angeles Superior Court against Golden States Water
2 Company, American States Water Company, et al.

3 62. On January 6, 2009, Staff filed proposed accounting order language for the treatment
4 of the deferred Municipal and Industrial charges related to the Company's 2997 CAP allocation
5 purchase.

6 63. On January 8, 2009, the hearing reconvened. The Company, RUCO and Staff
7 appeared, presented evidence, and cross-examined witnesses. The hearing concluded on January 9,
8 2009.

9 64. On January 13, 2009, RUCO filed a response to Staff's Proposed Accounting Order.

10 65. On January 16, 2009, the Company filed its Final Schedules. On February 13, 2009,
11 the Company filed a Notice of Errata that included corrected Final Schedules reflecting its final
12 position in this case regarding rate case expense.

13 66. On January 16, 2009, RUCO filed its Final Schedules.

14 67. On January 16, 2009, RUCO filed a Notice of Errata with corrections to Hearing
15 Exhibits R-17 and R-18.

16 68. On January 21, 2009, Staff filed its Final Schedules.

17 69. On January 21, 2009, the Company filed its Response to Staff's Proposed Accounting
18 Order.

19 70. On January 21, 2009, the Company, Pacific Life, RUCO, and Staff filed a Stipulation
20 to Extend Briefing Schedule.

21 71. On January 28, 2009, the Company, Pacific Life, RUCO, and Staff filed initial closing
22 briefs on all issues with the exception of cost of capital and rate of return.

23 72. On January 29, 2009, Staff filed a Notice of Filing. The Notice stated that on January
24 12, 2009, the Company had provided responses to Staff's data requests related to the CPUC
25 investigation of Golden States, and that based on the responses, Staff concluded that additional
26 discovery was necessary, and that Staff would continue to provide updates on the issue in this docket.

27 73. On February 10, 2009, Staff filed a Motion to Compel requesting that the Commission
28 order the Company to promptly provide information requested by Staff related to the CPUC

1 investigation of Golden States.

2 74. On February 13, 2009, the Company, Pacific Life, RUCO, and Staff filed reply briefs
3 on all issues with the exception of cost of capital and rate of return.

4 75. On February 13, 2009, the Company, RUCO, and Staff filed closing briefs on cost of
5 capital and rate of return.

6 76. On February 18, 2009, Staff docketed an update to its February 10, 2009, Motion to
7 Compel. Staff indicated that Staff and the Company had agreed to extend the time period in which
8 the Company has to respond, pending the outcome of ongoing negotiations to resolve the Motion to
9 Compel.

10 77. On February 27, 2009, the Company, RUCO and Staff filed reply briefs on cost of
11 capital and rate of return.

12 78. On March 4, 2009, the Company filed a Notice of Filing Late-Filed Exhibit. The
13 exhibit attached thereto is a rate case expense itemization spreadsheet showing a total for January
14 2007 - December 2008.

15 79. On June 3, 2009, a procedural order was issued directing Staff to file an update on its
16 Motion to Compel and the progress made in its discovery related to the CPUC investigation of
17 Chaparral City Water Company's parent, Golden States Water Company. The procedural order
18 directed Staff to include in the update a recommendation regarding an appropriate procedural means
19 of addressing the CPUC investigation issue, including whether it should be addressed in this docket.
20 The procedural order also directed the Company, Pacific Life, and RUCO to file responses to Staff's
21 update.

22 80. On June 11, 2009, Staff filed a Request for Extension of Time. Therein, Staff stated
23 that all three of the attorneys assigned to this case had time constraint conflicts with appellate matters
24 and settlement negotiations in other cases to which they are assigned that prevent them from meeting
25 the June 12, 2009 deadline.

26 81. On June 12, 2009, the Company filed a Response in Opposition to Staff's Motion for
27 Extension of Time. The Company objected to Staff's request for a one-week extension of time
28 because, according to the Company, the update is not needed. The Company argued that the Motion

1 to Compel is moot because the Company provided all the documents Staff requested by mid-March,
2 2009. The Company stated that it had offered to stipulate to either (1) keep this docket open, pending
3 conclusion of Staff's review of the CPUC investigation documents and a determination of whether
4 any further proceedings or relief are warranted, or (2) to open a new docket for the same purpose, but
5 that Staff had not definitively responded to the stipulation offer.

6 82. On June 17, 2009, RUCO filed a Response to Staff's Request for Extension of Time,
7 indicating support for Staff's request.

8 83. On June 17, 2009, a procedural order was issued granting a one week time extension
9 for Staff's update.

10 84. On June 19, 2009, Staff filed its Update and Reply to Chaparral City Water
11 Company's Response. Staff stated that ultimately, Staff and the Company had resolved their
12 discovery dispute through the execution of a protective agreement, upon which the Company
13 provided Staff with over 15,000 pages of documents. Staff stated that its investigation was ongoing,
14 and that Staff had not yet determined whether the Company's activities rise to the level of
15 impropriety or wrongdoing or impact the Company's rates or this pending rate case. Staff stated that
16 it had retained an outside consultant to assist in Staff's review of the documents and to determine
17 whether any alleged improprieties have impacts for this rate case. Staff stated that it found the
18 Company's stipulation proposal acceptable, as long as all parties acknowledge that rates could be
19 modified if the investigation yields circumstances which would warrant such action.

20 85. On June 23, 2009, RUCO filed its Response to Staff's Update Regarding the CPUC
21 Investigation. RUCO agrees that there has been insufficient time to review and analyze the
22 documentation which the Company produced on March 10, 13 and 16, 2009. RUCO stated that it
23 does not object to having this matter proceed, but with the docket remaining open subject to
24 reconsideration in the event that the investigation by Staff, RUCO, or the CPUC reflects impropriety
25 by Chaparral or its parent, officers or employees.

26 86. On June 25, 2009, the Company filed a Response to Staff's Update. The Company
27 asserted that there is no reason to delay rate relief, and requested the issuance of a decision in this
28 matter as soon as possible.

1 87. It is reasonable to require Staff to file by January 15, 2009, with docket control, as a
2 compliance item in this docket, a report documenting its review of the CPUC investigation
3 documents, and to require Staff to indicate in the report its findings and a recommendation regarding
4 whether any further proceedings or relief are warranted in this docket.

5 88. It is reasonable under the circumstances to make the rates approved herein interim
6 rates subject to modification in the event the ongoing Staff investigation reveals the existence of
7 circumstances which would warrant such action.

8 89. Under the circumstances of this case, it is not reasonable or in the public interest to
9 grant the Company's request for a "delay surcharge."

10 90. As discussed herein, an appropriate and reasonable capital structure for the Company
11 is 24 percent debt and 76 percent equity. The cost of debt is 5.0 percent, and an appropriate and
12 reasonable cost of equity is 9.9 percent.

13 91. In the test year ended December 31, 2006, the Company experienced Operating
14 Income of \$926,627, on total revenues of \$7,505,010 for a 3.35 percent rate of return on FVRB.

15 92. The Company requested rates that would result in total revenues of \$10,357,363, a
16 revenue increase of \$2,852,353, or 38.01 percent. RUCO recommended rates that would yield total
17 revenues of \$8,649,874, an increase of \$1,144,864 or 15.25 percent. Staff recommended total
18 revenues of \$9,350,843 an increase of \$1,904,143 or 25.57 percent.

19 93. As discussed herein, the Company's FVRB is determined to be \$27,620,414.

20 94. A FVROR on FVRB of 7.52 percent is reasonable and appropriate.

21 95. The revenue increase requested by the Company would produce an excessive return
22 on FVRB.

23 96. The Company's gross revenue should increase by \$1,896,281.

24 97. Under the Company's proposed rates, an average usage (8,400 gallons/month)
25 residential customer on a 3/4-inch meter would experience an increase of \$10.90, approximately 34
26 percent, from \$32.28 per month to \$43.27 per month.

27 98. Under the rates adopted herein, an average usage (8,400 gallons/month) residential
28 customer on a 3/4-inch meter would experience a monthly rate increase of \$6.05, approximately

1 16.68 percent, from \$32.37 per month to \$38.42 per month.

2 99. It is reasonable and in the public interest to correct the rate design disparity for
3 irrigation customers adopted in Decision No. 68176 by charging Irrigation and Construction water
4 customers the monthly minimum charges by meter size and a flat commodity rate equal to the first
5 tier commodity rate for other commercial and industrial customers.

6 100. The Company should be required to perform a monitoring exercise of its water system
7 as recommended by Staff, to docket the results by March 10, 2010, and to comply with the filing
8 requirements recommended by Staff and ordered herein, in the event the reported water loss is greater
9 than 10 percent. In no case should water loss be allowed to remain at 15 percent or greater.

10 101. The Company should be required to perform and submit a lead/lag study in
11 conjunction with its next rate application in order to meet the sufficiency requirements of that filing.

12 102. The property tax expense calculation methodology recommended by Staff is
13 reasonable and should be adopted.

14 103. Because CCWC acted prudently under the circumstances in its December, 2007, \$1.28
15 million purchase of the additional CAP allocation, the acquisition cost of the additional CAP
16 allocation should be included in rate base, classified as a plant-in-service component of Land and
17 Land Rights, and not subject to amortization.

18 104. CCWC should be allowed recovery of fifty percent of the CAP M&I charges related to
19 the additional CAP allocation, or \$20,306, as an operating expense.

20 105. CCWC should be allowed to defer, for possible later recovery through rates, the other
21 fifty-percent of its costs, excluding any interest or other carrying charges, incurred for the annual
22 CAP M&I charges.

23 106. CCWC should be authorized to create a deferral account to accrue these charges
24 beginning on January 1, 2008, which is the first time the CAP M&I charges are applicable according
25 to the contract.

26 107. The cost deferral authorization granted herein will allow consideration of, but not
27 guarantee recovery of these costs in future ratemaking proceedings.

28 108. CCWC should be required to prepare and retain accounting records sufficient to

1 permit detailed review of all deferred costs in a rate proceeding.

2 109. CCWC's deferral authority is limited to 48 months from January 1, 2008, unless
3 Chaparral City Water Company, Inc. has a general rate case pending at the end of the 48 month
4 period, in which case Chaparral City Water Company, Inc. may continue to defer these costs until
5 such rate case is concluded. Chaparral City Water Company, Inc. shall address the deferred amounts
6 recorded as of ninety days before the due date for filing Staff's Direct Testimony in the rate case.
7 Any additional properly deferred amounts recorded after that date may be considered in subsequent
8 rate case(s).

9 110. CCWC should be allowed to seek to include the accumulated deferred balance
10 associated with all amounts deferred pursuant to this Decision in the cost of service for rate-making
11 purposes in Chaparral City Water Company, Inc.'s next general rate case. Nothing in this Decision
12 shall be construed to limit this Commission's authority to review such balance and to make
13 disallowances thereof due to imprudence, errors or inappropriate application of the requirements of
14 this Decision.

15 111. This Decision should not be construed in any way to limit this Commission's authority
16 to review the entirety of the acquisition and to make any disallowances thereof due to imprudence,
17 error or inappropriate application of the requirements of this Decision.

18 112. ADEQ's formally delegated agent, the Maricopa County Environmental Services
19 Department ("MCESD") has determined that the CCWC drinking water system, PWS #07-017, is
20 currently delivering water that meets quality standards required by the Arizona Administrative Code,
21 Title 18, Chapter 4.

22 113. The Company's service territory is within the Phoenix Active Management Area
23 ("AMA"), and the Arizona Department of Water Resources ("ADWR") has reported that the
24 Company is in compliance with its requirements governing water providers.

25 114. The Company has no delinquent Arizona Corporation Commission compliance issues.

26 115. The Company has an approved curtailment plan tariff that became effective on
27 October 1, 2005.

28 116. The Company has an approved backflow prevention tariff that became effective on

1 October 1, 2005.

2 117. The Company should be required to use, on a going-forward basis, the depreciation
3 rates set forth at Table J-1 of the Engineering Report attached to the Direct Testimony of Staff
4 witness Marlin Scott, Jr.

5 **CONCLUSIONS OF LAW**

6 1. CCWC is a public service corporation pursuant to Article XV of the Arizona
7 Constitution and A.R.S. §§ 40-250 and 40-251.

8 2. The Commission has jurisdiction over CCWC and the subject matter of the
9 application.

10 3. Notice of the proceeding was provided in conformance with law.

11 4. The fair value of CCWC's rate base is \$27,620,414, and applying a 7.52 percent fair
12 value rate of return on this fair value rate base produces rates and charges that are just and reasonable.

13 5. The rates and charges approved herein are reasonable.

14 6. Administrative notice is taken of the complete record of Docket No. W-02113A-04-
15 0616.

16 7. It is reasonable to require Staff to file by January 15, 2009, with docket control, as a
17 compliance item in this docket, a report documenting its review of the CPUC investigation
18 documents, and to require Staff to indicate in the report its findings and a recommendation regarding
19 whether any further proceedings or relief are warranted in this docket and when interim rates become
20 permanent.

21 8. It is reasonable under the circumstances to make the rates approved herein interim
22 rates subject to modification in the event the ongoing Staff investigation reveals the existence of
23 circumstances which would warrant such action.

24 9. It is reasonable and in the public interest to require the Company to perform a
25 monitoring exercise of its water system as recommended by Staff, to docket the results by March 10,
26 2010, and to comply with the filing requirements recommended by Staff and ordered herein, in the
27 event the reported water loss is greater than 10 percent. It is reasonable and in the public interest to
28 require that in no case shall water loss be allowed to remain at 15 percent or greater.

1	Monthly Service Charge for Fire Sprinkler	
	4" or smaller Meter	10.00
2	6" Meter	10.00
	8" Meter	10.00
3	10" or larger Meter	10.00

4 COMMODITY RATES

5	Per 1,000 Gallons	
	(Residential, Commercial, Industrial)	
6	3/4-inch Meter - Residential	
	0-3,000 Gallons	\$2.23
7	3,001 - 9,000 Gallons	2.80
	Over 9,000 Gallons	3.33
8	3/4-inch Meter - Commercial and Industrial	
	0 - 9,000 Gallons	2.80
9	Over 9,000 Gallons	3.33
10	1-inch Meter	
	0 to 24,000 Gallons	2.80
11	Over 24,000 Gallons	3.33
12	1 1/2- inch Meter	
	0 to 60,000 Gallons	2.80
13	Over 60,000 Gallons	3.33
14	2-inch Meter	
	0 to 100,000 Gallons	2.80
	Over 100,000 Gallons	3.33
15	3-inch Meter	
	0 to 225,000 Gallons	2.80
16	Over 225,000 Gallons	3.33
17	4 - inch Meter	
	0 to 350,000 Gallons	2.80
18	Over 350,000 Gallons	3.33
19	6-inch Meter	
	0 to 725,000 Gallons	2.80
	Over 725,000 Gallons	3.33
20	8 - inch Meter	
	0 to 1,125,000 Gallons	2.80
21	Over 1,125,000 Gallons	3.33
22	10 -inch Meter	
	0 to 1,500,000 Gallons	2.80
23	Over 1,500,000 Gallons	3.33
24	12 - inch Meter	
	0 to 2,250,000 Gallons	2.80
25	Over 2,250,000 Gallons	3.33

26
27
28

1	Irrigation and Construction /Bulk –	
	All Gallons	2.80
2	Fire Hydrant Irrigation/Construction –	
	All Gallons	2.80
3	Standpipe (Fire Hydrants) – All Gallons	2.80
	Fire Sprinklers – All Gallons	2.80

SERVICE CHARGES:

6	Establishment of Service:	
	Regular Hours	\$25.00
7	After Hours	35.00
	Reestablishment of Service (within 12 months)	*
8	Reconnection of Service (Delinquent):	
	Regular Hours	35.00
9	After Hours	50.00
10	Water Meter Test (If Correct)	35.00
	Water Meter relocation at Customer Request	Cost
11	(Per ACC Rule 14-2-405(B))	
	Meter Re-Read (If Correct)	\$25.00
12	NSF Check Charge	25.00
13	Late Fee Charge	1.5% per month
	Deferred Payment Finance Charge	1.5% per month
14	Service Call – After Hours	Refer to charges above
	(Per ACC Rule 14-2-403(D))	
15	Deposit Requirements Residential	**
	Deposit Requirements Non-Residential	**
16	Deposit Interest	***

17 * Monthly Minimum times Months Disconnected
 18 From the Water System
 (Per A.A.C. Rule 14-2-403(D))
 19 **Residential – two times the average bill.
 20 Non-residential – two and one-half times the
 estimated maximum bill.
 21 ***Interest per (Per ACC Rule 14-2-403(B)).

OFF-SITE FACILITIES HOOK-UP FEE:

23	5/8" x 3/4" Meter	****
	3/4" Meter	****
24	1" Meter	****
	1 1/2" Meter	****
25	2" Meter	****
	3" Meter	****
26	4" Meter	****
	6" or Larger Meter	****

**** The fee shall be variable, fixed on January 1 of each calendar year, computed by dividing \$369,404.50 by the number of hook-ups during the previous calendar year. However, in no event shall the hook-up fee be higher than \$1,000 nor less than \$500.

2006 filing – New water installations. May be assessed only once per parcel, service connection, or lot within a subdivision. Purpose is to equitably apportion the costs of construction additional off-site facilities to provide water production, delivery, storage, and pressure among all new service connections.

SERVICE LINE AND METER INSTALLATION CHARGES:

	<u>Service Line Charge</u>	<u>Meter Charge</u>	<u>Total Charge</u>
5/8" x 3/4" Meter	\$ 385.00	\$ 135.00	\$ 520.00
3/4" Meter	385.00	215.00	600.00
1" Meter	435.00	255.00	690.00
1-1/2" Meter	470.00	465.00	935.00
2" Turbine	630.00	965.00	1,595.00
2" Compound	630.00	1,690.00	2,320.00
3" Turbine	805.00	1,470.00	2,275.00
3" Compound	845.00	2,265.00	3,110.00
4" Turbine	1,170.00	2,350.00	3,520.00
4" Compound	1,230.00	3,245.00	4,475.00
6" Turbine	1,730.00	4,545.00	6,275.00
6" Compound	1,770.00	6,280.00	8,050.00
8" or Larger	At Cost	At Cost	At Cost

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 Commission Rule 14-2-408(D)(5).

All advances and/or contributions are to include labor, materials, overheads, and all applicable taxes, including all gross-up taxes for income taxes, if applicable.

IT IS FURTHER ORDERED that the Low Income Tariff attached hereto as Exhibit A is hereby adopted and shall be included with the tariffs filed in accordance with the Ordering Paragraph above.

IT IS FURTHER ORDERED that this docket shall remain open, pending conclusion of the parties' review of the California Public Utilities Commission investigation documents.

IT IS FURTHER ORDERED that the rates approved herein are interim rates subject to modification in the event the ongoing Staff investigation related to the California Public Utilities Commission investigation documents reveals the existence of circumstances which would warrant

1 such action.

2 IT IS FURTHER ORDERED that Staff shall file by January 15, 2009, with Docket Control,
3 as a compliance item in this docket, a report documenting its review of the California Public Utilities
4 Commission investigation documents. The report shall indicate Staff's findings and a
5 recommendation regarding whether any further proceedings or relief are warranted in this docket.

6 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. shall notify the
7 Commission within thirty days of a sale of Well No. 8 or Well No. 9 by means of a filing in this
8 docket setting forth the terms of such sale, and shall include the sharing of the gain on such a sale
9 with the ratepayers in the next rate filing subsequent to the sale.

10 IT IS FURTHER ORDERED that the property tax expense calculation methodology
11 recommended by Staff is hereby adopted

12 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. shall begin a 12-
13 month monitoring exercise of its water system after the Company completes its own Central Arizona
14 Project water meter installation, and shall docket the results of the system monitoring as a compliance
15 item in this case by March 1, 2010. If the reported water loss for the period from February 1, 2009
16 through February 1, 2010 is greater than 10 percent, the Company shall prepare, and file, by April 30,
17 2010, as a compliance item for this proceeding for review and certification by Staff, a report
18 containing a detailed analysis and plan to reduce water loss to 10 percent or less, or alternatively, if
19 the Company believes it is not cost effective to reduce water loss to less than 10 percent, the
20 Company shall submit a detailed cost benefit analysis to support its opinion. In no case shall water
21 loss be allowed to remain at 15 percent or greater.

22 IT IS FURTHER ORDERED that because Chaparral City Water Company, Inc. acted
23 prudently under the circumstances in its December, 2007, \$1.28 million purchase of the additional
24 Central Arizona Project allocation, the acquisition cost of the additional allocation should be included
25 in rate base, classified as a plant-in-service component of Land and Land Rights, and not subject to
26 amortization.

27 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. shall be allowed
28 recovery of fifty percent of the Central Arizona Project Municipal and Industrial charges related to

1 the additional Central Arizona Project allocation, or \$20,306, as an operating expense in this case.

2 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. is hereby authorized
3 to defer, for possible later recovery through rates, the remaining fifty-percent of its costs, excluding
4 any interest or other carrying charges, incurred for the annual Central Arizona Project Municipal and
5 Industrial charges, and absolutely nothing in this Decision shall be construed in any way to limit this
6 Commission's authority to review the entirety of the acquisition and to make any disallowances
7 thereof due to imprudence, error or inappropriate application of the requirements of this Decision.

8 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. is authorized to create
9 a deferral account to accrue the authorized deferral charges beginning on January 1, 2008, which is
10 the first time the Municipal and Industrial charges are applicable according to the contract.

11 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. shall prepare and
12 retain accounting records sufficient to permit detailed review, in a rate proceeding, of all deferred
13 costs recorded as authorized above.

14 IT IS FURTHER ORDERED that the cost deferral authorization granted herein will allow
15 consideration of, but not guarantee recovery of these costs in future ratemaking proceedings.

16 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc.'s deferral authority is
17 limited to 48 months from January 1, 2008, unless Chaparral City Water Company, Inc. has a general
18 rate case pending at the end of the 48 month period, in which case Chaparral City Water Company,
19 Inc. may continue to defer these costs until such rate case is concluded. Chaparral City Water
20 Company, Inc. shall address the deferred amounts recorded as of ninety days before the due date for
21 filing Staff's Direct Testimony. Any additional properly deferred amounts recorded after that date
22 may be considered in subsequent rate case(s).

23 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. may seek to include
24 the accumulated deferred balance associated with all amounts deferred pursuant to this Decision in
25 the cost of service for rate-making purposes in Chaparral City Water Company, Inc.'s next general
26 rate case. Nothing in this Decision shall be construed to limit this Commission's authority to review
27 such balance and to make disallowances thereof due to imprudence, errors or inappropriate
28 application of the requirements of this Decision.

1 IT IS FURTHER ORDERED that Chaparral City Water Company, Inc. shall perform and
2 submit a lead/lag study in conjunction with its next rate adjustment request application in order to
3 meet the sufficiency requirements of that filing.

4 IT IS FURTHER ORDERED that administrative notice is hereby taken in this docket of the
5 complete record of Docket No. W-02113A-04-0616.

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

7 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

8
9
10 CHAIRMAN _____ COMMISSIONER

11
12 COMMISSIONER _____ COMMISSIONER _____ COMMISSIONER

13
14 IN WITNESS WHEREOF, I, ERNEST G. JOHNSON,
15 Executive Director of the Arizona Corporation Commission,
16 have hereunto set my hand and caused the official seal of the
17 Commission to be affixed at the Capitol, in the City of Phoenix,
18 this ____ day of _____, 2009.

19 _____
20 ERNEST G. JOHNSON
21 EXECUTIVE DIRECTOR

22 DISSENT _____

23 DISSENT _____
24
25
26
27
28

1 SERVICE LIST FOR: CHAPARRAL CITY WATER COMPANY, INC.

2 DOCKET NO.: W-02113A-07-0551

3
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10 Phil Green
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12 (EM), LLC
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21 1200 West Washington Street
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20 Steve Olea, Director
21 Utilities Division
22 ARIZONA CORPORATION COMMISSION
23 1200 West Washington Street
24 Phoenix, AZ 85007

24
25
26
27
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EXHIBIT A

**CHAPARRAL CITY WATER COMPANY (CCWC)
ALTERNATE RATES FOR WATER (ARW)
DOMESTIC SERVICE – SINGLE FAMILY ACCOMMODATION**

APPLICABILITY

Applicable to residential water service for domestic use rendered to low-income households where the customer meets all the Program Qualifications and Special Conditions of this rate schedule.

TERRITORY

Within all Customer Service Areas served by the Company.

RATES

Fifteen percent (15%) discount applied to the regular filed tariff.

PROGRAM QUALIFICATIONS

1. The CCWC bill must be in your name and the address must be your primary residence or you must be a tenant receiving water service by a sub-metered system in a mobile home park.
2. You may not be claimed as a dependent on another person's tax return.
3. You must reapply each time you move.
4. You must renew your application every two years, or sooner, if requested.
5. You must notify CCWC within 30 days if you become ineligible for ARW.
6. Your total gross annual income of all persons living in your household cannot exceed the income levels below:

Effective October 15, 2009

<u>No. of Person In Household</u>	<u>Total Gross Annual Income</u>
1	\$15,600
2	21,000
3	26,400
4	31,800
5	37,200
6	42,600

For each additional person residing in the household, add \$5,400.

(Continued)

EXHIBIT A

For the purpose of the program the "gross household income" means all money and non cash benefits, available for living expenses, from all sources, both taxable and non taxable, before deductions for all people who live in my home. This includes, but is not limited to:

Wages or salaries	Social Security, SSI, SSP	Rental or royalty income
Interest or dividends from:	Scholarships, grants, or other aid	Profit from self-employment
Savings accounts, stocks or bonds	used for living expenses	(IRS form Schedule C, Line 29)
Unemployment benefits	Disability payments	Worker's Compensation
TANF(AFDC)	Food Stamps	Child Support
Pensions	Insurance settlements	Spousal Support
Gifts		

SPECIAL CONDITIONS

1. **Application and Eligibility Declaration:** An Application and eligibility declaration on a form authorized by the Commission is required for each request for service under this schedule. Renewal of a customer's eligibility declaration will be required, at least, every two years.
2. **Commencement of Rate:** Eligible customers shall be billed on this schedule commencing with the next regularly scheduled billing period that follows receipt of application by the Utility.
3. **Verification:** Information provided by the applicant is subject to verification by the Utility. Refusal or failure of a customer to provide documentation of eligibility acceptable to the Utility, upon request by the Utility, shall result in removal from this rate schedule.
4. **Notice From Customer:** It is the customer's responsibility to notify the Utility if there is a change of eligibility status.
5. **Rebilling:** Customers may be re-billed for periods of ineligibility under the applicable rate schedule.
6. **Mobile home Park and Master-metered:** A reduction will be calculated in the bill of mobile home park and master-metered customers, who have sub-metered tenants that meet the income eligibility criteria, so an equivalent discount (15%) can be passed through to eligible customer(s).