

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 KRISTIN K. MAYES
CHAIRMAN

3 GARY PIERCE
COMMISSIONER

4 SANDRA D. KENNEDY
COMMISSIONER

5 PAUL NEWMAN
COMMISSIONER

6 BOB STUMP
COMMISSIONER

7
8 IN THE MATTER OF THE APPLICATION OF
9 BELLA VISTA WATER CO., INC., AN
10 ARIZONA CORPORATION, FOR A
11 DETERMINATION OF THE FAIR VALUE OF
12 ITS UTILITY PLANTS AND PROPERTY AND
13 FOR INCREASES IN ITS WATER RATES
14 AND CHARGES FOR UTILITY SERVICE
15 BASED THEREON.

Docket No. W-02465A-09-0411

12 IN THE MATTER OF THE APPLICATION OF
13 NORTHERN SUNRISE WATER COMPANY,
14 INC., AN ARIZONA CORPORATION, FOR A
15 DETERMINATION OF THE FAIR VALUE OF
16 ITS UTILITY PLANTS AND PROPERTY AND
17 FOR INCREASES IN ITS WATER RATES
18 AND CHARGES FOR UTILITY SERVICE
19 BASED THEREON.

Docket No. W-20453A-09-0412

17 IN THE MATTER OF THE APPLICATION OF
18 SOUTHERN SUNRISE WATER COMPANY,
19 INC., AN ARIZONA CORPORATION, FOR A
20 DETERMINATION OF THE FAIR VALUE OF
21 ITS UTILITY PLANTS AND PROPERTY AND
22 FOR INCREASES IN ITS WATER RATES
23 AND CHARGES FOR UTILITY SERVICE
24 BASED THEREON.

Docket No. W-20454A-09-0413

21 IN THE MATTER OF THE JOINT
22 APPLICATION OF BELLA VISTA WATER
23 CO., INC., NORTHERN SUNRISE WATER
24 COMPANY, INC., AND SOUTHERN
SUNRISE WATER COMPANY., INC., FOR
APPROVAL OF AUTHORITY TO

Docket No. W-02465A-09-0414

Docket No. W-20453A-09-0414

Docket No. W-20454A-09-0414

1 CONSOLIDATE OPERATIONS, AND FOR
2 THE TRANSFER OF UTILITY ASSETS TO
3 BELLA VISTA WATER CO., INC,
PURSUANT TO ARIZONA REVISED
STATUTES 40-285.

4
5 **RUCO’S REPLY BRIEF**

6 The Residential Utility Consumer Office (“RUCO”) hereby files its Reply Brief in the
7 above-referenced cases regarding Bella Vista Water Company, Northern Sunrise Water
8 Company and Southern Sunrise Water Company, (hereinafter referred to as “Bella Vista,”
9 “Northern” and “Southern,” respectively on a stand-alone basis and collectively referred to as
10 “BVWC” or the “Company” on a consolidated basis.)

11 **I. RESOLVED ISSUES**

12 In addition to the issues identified in its initial closing brief, the parties have also resolved
13 the following issue:

14 **A. Retirements**

15 The Company corrected its failure to retire certain plant on its books and records to
16 address RUCO’s concerns. In surrebuttal, RUCO concurred with the retirements made by the
Company.¹

17 **II. ISSUES IN DISPUTE**

18 **A. Operating Expenses**

19 **1. The Applicant has the burden of proof.**

20 The Company argues in its Closing Brief that Staff and RUCO have the burden of proof
21 and must demonstrate their adjustments by “substantial evidence.” In essence, the Company
22 seeks to shift the burden of proof. The Company appears at first to ignore its burden of proof.

23 _____

24 ¹ See Exhibit R-11, Surrebuttal Testimony of Rodney Moore at 7.

1 Pursuant to R14-3-109G, the Applicant in a ratemaking proceeding has the burden of proof.
2 Unless the Company demonstrates its requests for plant and expenses are reasonable,
3 necessary for the provision of utility service and beneficial to ratepayers, it has failed to meet
4 its burden.

5 Second, RUCO disputes that it has the burden of proof or that it must demonstrate its
6 adjustments by “substantial evidence.”² In the *Matter of Southwest Gas*, Decision No. 68487,
7 RUCO sought to exclude insufficiently documented costs from operating expense.³ Southwest
8 Gas asserted that RUCO had the burden of proving the expenses were unreasonable. *Id.*
9 The Commission discounted Southwest’s assertion that RUCO had the burden of disproving
10 expenses and observed that even the utility’s authorities recognized that once a party
11 challenges a Company’s application with “some credible evidence,” it is incumbent on the
12 utility to demonstrate the reasonableness of its proposals. *Id.* 21-22. The Commission did not
13 shift the burden to ratepayers and it did not impose a “substantial” evidence standard, as
14 proposed by BVWC. Likewise, in the *Matter of Black Mountain*, the Commission reiterated the
15 position expressed in *Southwest Gas* stating:

16 “it is incumbent on the company seeking recovery of a wide array of corporate
17 office expenses to show that the type of costs being allocated are reasonably
18 necessary for the provision of utility service provided and that the level of
19 expense is reasonable.”⁴

20 RUCO asserts that it has raised credible arguments for disallowances of expenses.
21 Therefore, consistent with the Commission’s ruling in Decision No. 68487 and Decision No.

22 ² Note: RUCO does not dispute that the multiple authorities cited by the Company apply a “substantial
23 evidence” standard of review to appeals from administrative rulings. However, the standard of review in
24 administrative appeals is not the same as the burden of proof in an administrative hearing.

³ *In the Matter of Southwest Gas*, 270 P.U.R. 4th 465, Docket No. G-01551A-07-0504, Decision No. 68487
(February 23, 2006) at 22.

⁴ *In the Matter of Black Mountain*, Docket No. SW-02361A-08-0609, Decision No. 71865 (September
1, 2010) at 24.

1 71865, the burden falls to the Company to prove its expenses are reasonable, necessary to
2 the provision of utility services and beneficial to ratepayers.

3 **2. The Commission’s constitutional power to determine just and reasonable**
4 **rates is not limited by a presumption of “reasonableness” in favor of**
5 **utilities.**

6 In this case, the Company has claimed that the Commission need not examine and
7 evaluate the reasonableness of the affiliate-related billings which comprise the majority of the
8 APT cost pool.⁵ Essentially, the Company is arguing that there is a “presumption” that its
9 expenses in the APT cost pool are reasonable without further examination of the billings. In
10 Decision No. 68487, Southwest Gas made a similar argument. *Id.* at 22. In response, the
11 Commission held that the overriding principle of ratemaking is to arrive at just and reasonable
12 rates and reasserted that it was the Commission which ultimately determined if expenses were
13 reasonable and beneficial to ratepayers. *Id.* at 23-24. The Commission held that its decision-
14 making authority is not limited by any presumption of reasonableness in favor of the utility and
15 stated:

16 ...[W]e disagree with the position, advocated by Southwest Gas, that our
17 consideration of the reasonableness of any particular expense may not include
18 recognition of the relative benefits that may be derived from such costs...The test
19 of reasonableness is based on a host of considerations presented in the record
20 and may not be reduced to a simple pass-through of costs claimed by the
21 Company in order to pass legal muster. The Commission's ratemaking authority
22 allows precisely the type of analysis that has been conducted with respect to
23 these expense items and is consistent with case law interpreting that authority.⁶

24 The Commission can look at any number of factors to determine whether the Company’s APT
expenses are reasonable, necessary to the provision of utility service and beneficial to

⁵ T: 447, ll. 9-25.

⁶ See Decision No. 68487 at 21-22.

1 ratepayers. The Commission's determination is not bound by a "presumption of
2 reasonableness" in favor of the Company.

3 **3. The Company's affiliate-related billings should be subject to greater**
4 **scrutiny and denied for the same reasons they were denied in Black**
5 **Mountain.**

6 The Company suggests in its Initial Closing Brief that the scrutiny to which it is subject is
7 unfair as compared to the Commission's scrutiny of other utilities.⁷ RUCO asserts that the
8 APT costs are, in large part, a conglomerate of affiliate-related billings and therefore subject to
9 greater scrutiny by the Commission. RUCO's position is supported by the Commission's
10 Decision No. 71865 in the *Matter of Black Mountain*, another Liberty Water affiliate.⁸ In
11 Decision No. 71865, the Commission held:

12 [C]ommon expenses incurred and allocated to the regulated utility companies
13 must provide a clearly defined benefit to customers to be considered
14 reasonably necessary for the provision of service...cost of services provided
15 by affiliated entities, under a non-negotiated no-bid agreements, must be given
16 **greater scrutiny** because the company being billed for those services is
17 effectively without input regarding the types of services provided, or the cost of
18 those services. In addition, the subsidiary company has virtually no recourse
19 against the parent company's decision to assess common expenses that are
20 incurred at the parent level.⁹ (Emphasis added)

21 The expenses BVWC seeks to allocate are affiliate-related expenses. According to the
22 Company, many of the expenses are related to APT's status as a publicly-traded company on
23 the Toronto Stock Exchange ("TSX"). The Company is also attempting to pass on \$273,965 of
24 rental expense which APT pays Bristol Circle Partners.¹⁰ As RUCO explained in its Closing
25 Brief, Bristol Circle Partners is owned by Messrs. Jarrat, Kerr and Robertson, who are

26 ⁷ See the Company's Initial Closing Brief at 27.

27 ⁸ See Decision No. 71865 at 21-24.

28 ⁹ Id. at 23

29 ¹⁰ See Exhibit R-19, Company's Responses to RUCO's DRs.

1 shareholders and/or directors of APUC, and former managers of APIF.¹¹ The Company also
2 seeks to include \$563,803 of management fees in its cost allocation pool. Id. The management
3 fees were paid to Messrs. Jarrat, Kerr, and Robertson, the former fund managers of APIF, and
4 related parties. Id. Payment of rent, management fees and exchange related expenses to APT
5 are affiliate transactions. As such, the APT cost allocations are subject to greater scrutiny and
6 the special considerations outlined in the NARUC Guidelines on Cost Allocations and
7 Affiliates.¹²

8 In reviewing the Company's shared service model in *Black Mountain*, the Commission
9 held:

10 The central office expenses are intermingled between the regulated and
11 unregulated companies to such an extent that it is not appropriate to allow an
12 across-the-board recognition of all such expenses for purposes of setting
13 rates.¹³

14 The APT cost allocation in BVWC is based on the same shared service model reviewed
15 by the Commission in *Black Mountain* and should be subject to the same level of scrutiny and
16 findings.

17 RUCO's witness, Mr. Coley, testified that the APT invoices are insufficiently detailed to
18 determine whether the costs should be billed directly to unregulated affiliates or indirectly
19 shared by all affiliates.¹⁴ He testified that some of the costs should have been directly
20 allocated to the BVWC's unregulated parent or other unregulated affiliates.¹⁵ Mr. Coley also
21 testified that charging ratepayers any amount that should have been properly allocated to the

22 ¹¹ T: 441-460. See also RUCO's Closing Brief at 12-13.

23 ¹² See R-20 NARUC Guidelines for Cost Allocations and Affiliate Transactions.

24 ¹³ Id. at 24.

¹⁴ T: 712-715.

¹⁵ Id.

1 Company's unregulated parent or affiliates would be unreasonable and inconsistent with
2 NARUC guidelines. Id. Ms. Brown, Staff's witness, agreed and testified that the APT costs
3 were obviously attributable to the Company's parent or one of its unregulated affiliates.¹⁶
4 BVWC's central office expenses are intermingled between regulated and unregulated
5 companies, just as they were in *Black Mountain*. Accordingly, consistent with the ruling in
6 *Black Mountain*, the BVWC cost allocation should not receive across the board recognition.
7 RUCO recommends disallowance of the APT cost allocation for the same reasons the
8 Commission excluded them in the *Black Mountain* case.

9 **4. The Company's central office costs are unreasonable and should be denied.**

10 The Company asserts that the APT costs are reasonable because the allocation amounts to
11 \$1.09 per month per customer. The amount of the cost should have no bearing on whether
12 the cost should be recovered or not. The Company should not be able to recover a cost no
13 matter how small, if it is not necessary for the provision of service to ratepayers.

14 Mr. Coley also testified that the APT costs were also unreasonable and excessive in
15 comparison to other Arizona utilities because of the high labor/wage expense.¹⁷ He testified
16 that BVWC's monthly wage cost was \$14.11 per customer based on a 2008 pro-forma
17 labor/wage expense of \$1,627,526.¹⁸ Mr. Coley calculated the average monthly labor/wage
18 costs paid by the customers of 17 Arizona Water systems, five Arizona-American Water
19 systems and Chaparral Water, and found average monthly labor/wage costs per customer of
20 \$12.38, \$13.17 and \$8.97, respectively or \$11.51, on average per month per customer for all

21 _____
22 ¹⁶ See Exhibit S-6, Direct Testimony of Crystal Brown at 33.

23 ¹⁷ T: 540-44. See also Exhibit R-23, Notice of Errata, TJC-4. Note: Initially, Mr. Coley arrived at an average
24 monthly labor/wage expense of \$14.57 per customer for BVWC based on the Company's reported customer
count of 9,309, but modified his monthly labor/wage expense to \$14.11 after Company revealed on the stand that
the correct customer count was 9,610.

¹⁸ Id.

1 sampled systems. Id. at 2-3. The Company argues that its overall monthly expenses are on
2 par with other Arizona utilities. RUCO disagrees because the Company's overall comparison
3 does not adjust for specific costs associated with CAP water acquisition or particularly difficult
4 water distribution system which is not the case in BVWC's system. While the Company may
5 be critical of RUCO's analysis of more isolated costs, RUCO's labor/wage study demonstrates
6 that including the APT cost allocations on top of the Liberty Water direct allocations results in
7 an increase in BVWC ratepayers' average monthly expenses which is not reasonable when
8 compared to other Arizona utilities.

9 Beyond general assertions that APT's access to capital markets provides some benefit
10 to ratepayers, the Company has not provided sufficient proof that the APT costs were
11 reasonable and provided benefit to BVWC ratepayers in the test year. In the *Matter of Black*
12 *Mountain*, the Commission held that:

13 ...[I]t is not sufficient to simply make the claim that there exists a nebulous,
14 undefined benefit that may provide a benefit to the regulated subsidiary and
15 ultimately customer. Rather it is incumbent on the company seeking recovery of
16 a wide array of corporate office expenses to show that the type of costs being
17 allocated are reasonably necessary for the provision of utility service provided,
18 and that the level of such expenses is reasonable.¹⁹

19 The Company suggests that APT's only business is to provide services to the facilities and
20 utilities owned by APIF and that the affiliates would not have access to the capital markets
21 without APT expenditures. While that may be true, the Company has not demonstrated that
22 any portion of the APT costs provided a specific benefit to BVWC's ratepayers in the test year.
23 On the other hand, Ms. Brown testified that APT spent considerable resources on acquisition
24

¹⁹ See Decision No. 71865 at 24.

1 and sale of other affiliates in the test year.²⁰ The APT costs do not reflect direct billings to
2 those APT business objective and activities. Staff asserts and RUCO agrees that the business
3 objectives and activities of the unregulated parent and affiliates were the driving force behind
4 the APT costs.²¹

5 In its Initial Closing Brief, the Company asserts that RUCO and Staff's adjustments are
6 based on red herrings and nonsense.²² The Company's 2008 quarterly reports reflect that its
7 expenditures during the test year were focused on the acquisition of an affiliate, Highground
8 Capital, which included the issuance of 3.5 million trust units. Id. Moreover, the Company's
9 third quarterly report for 2008 reflects its potential acquisition of projects related to
10 development and/or repowering of eight power generation plants in the U.S. and Canada.²³
11 According to the Company's report: "Every acquisition and development project is subject to a
12 significant level of due diligence and financial modeling to ensure it satisfies the financial
13 objective of Algonquin Power and as such the likelihood of proceeding with acquisitions or
14 projects depends on the outcome of the activities." Id. In the first quarter of 2009, the
15 Company announced plans to co-acquire a California electric generation and distribution
16 facility, NV Energy, Inc. Id.

17 The Company's APT costs were related to the acquisition and development of the
18 parent or its power generation affiliates, most of which were unregulated. The Company failed
19 to show otherwise. It is not fair or reasonable to hoist these expenditures in any amount on
20 BVWC's ratepayers.

21
22 ²⁰ See Exhibit S-6, Direct Testimony of Crystal Brown at 32. See also Algonquin Power Quarterly Reports
23 for 2008 and 2009 attached to RUCO's Initial Closing Brief as Exhibit A, reflecting acquisitions of Highground
Capital, an affiliate, as well as acquisition and development of multiple power generation plants.

²¹ Staff Closing Brief at 14.

²² Company's Closing Brief at 43-45.

²³ See Exhibit A to RUCO's Closing Brief.

1 The Company also asserts that “RUCO’s witness reiterated that Bella Vista companies
2 used and benefited from \$1.6 million in capital provided through the TSX.”²⁴ It is true that Mr.
3 Coley testified that RUCO expects APT to use its access to the capital markets to benefit its
4 regulated utilities, including BVWC.²⁵ However, Mr. Coley did not testify that Bella Vista had
5 received such a benefit. He acknowledged that **if** the Company used \$1.6 million in capital
6 obtained through the TSX to upgrade Northern and Southern Sunrise, it would be useful.²⁶
7 However, he did not say that APT costs were used for such a purpose. In fact, on redirect, Mr.
8 Coley stated unequivocally that he could not tell from the APT costs which of those costs
9 contributed in any way, shape or manner to the improvement of the system or were beneficial
10 to ratepayers.²⁷ The Company has mischaracterized Mr. Coley’s testimony.

11 RUCO does not object to allowance of a small percentage of the APT cost allocation in
12 the amount of \$15,252 which is commensurate with the size of the BVWC and the level of its
13 needs.

14
15 **5. The Commission should not approve the Company’s request for \$375,000
in rate case expense.**

16 The Company asserts that Staff and RUCO failed to meaningfully consider the evidence
17 of actual rate case expense. RUCO meaningfully considered all of the evidence the Company
18 provided on this issue. The Company refused to provide a basis for projected rate case
19 expense despite several requests.²⁸ RUCO’s calculation included actual rate case expense
20 and in the absence of supporting documentation for the remaining expense, RUCO compared
21

22 ²⁴ Company’s Closing Brief at 29.

23 ²⁵ T: 640-641.

24 ²⁶ T: 640.

²⁷ T: 715.

²⁸ T: 306, 313. See RUCO’s Final Schedule RLM-12 at lines 7-8

1 the Company's request to the level of rate case expense approved in *Black Mountain*.²⁹ In
2 comparison to the rate case expense approved in *Black Mountain*, the Company's request is
3 excessive. Staff also evaluated the reasonableness of the Company's request by comparing it
4 to amounts approved in several other cases. Both RUCO and Staff independently evaluated
5 the Company's request for rate case expense, determined the request was unreasonable and
6 arrived at approximately the same recommendation of \$200,000 for rate case expense.³⁰ The
7 Company's request for rate case expense is not reasonable in light of the level of rate case
8 expense approved in *Black Mountain* or other comparable cases. Staff correctly points out
9 that the Company's reliance on outside experts and litigation support increases its rate case
10 expense disproportionately as compared to other Arizona utilities. Although the Company did
11 a better job of limiting rate case expense associated with discovery disputes at the latter part of
12 the case, it did not do so at the inception of the case.³¹ Only in recent months did the
13 Company rely more heavily on internal company litigation support, which was less expensive
14 than use of outside consultants and lawyers. For all of the reasons set forth in its Initial Closing
15 Brief and for the reasons set forth herein, RUCO requests that the Commission deny the
16 Company's request for rate case expense and approve RUCO's recommendation of \$200,000
17 or the Staff's independent recommendation of \$203,000.

18 **B. The Company's cost of capital should be rejected.**

19 RUCO incorporates by reference the arguments it made in its Initial Closing Brief in
20 support of its position and urges the Commission to adopt a 9.0 percent cost of equity. RUCO
21 supplements its prior arguments to address the Company's complaint regarding Staff's

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23 ²⁹ Id.

³⁰ Id. See also Exhibit S-7, Surrebuttal Testimony of Crystal Brown at 27. Staff initially estimated rate case
expense of \$153,000 on Direct. Thereafter, the Staff updated its estimate to \$203,000.

24 ³¹ Id.

1 financial risk adjustment. The Company asserts that Staff erred in using a Hamada
2 Adjustment to address the Company's absence of financial risk in comparison to other water
3 companies and implies that RUCO supports its position.³² The fact that RUCO generously
4 agreed to use the Company's capital structure should not be mistaken as criticism of Staff's
5 Hamada Adjustment. RUCO recognizes that Staff's use of a Hamada Adjustment of 100 basis
6 points is a means of adjusting for the absence of financial risk in the Company's capital
7 structure.

8 RUCO objects to the Company's 10.5 percent cost of equity because in its CAPM
9 analysis the Company relied on a high market risk premium, ignored widely-used geometric
10 means of market returns and used long-term treasury instruments, all of which contributed to
11 an overstated cost of equity capital. RUCO also disagrees with the Company's application of
12 a small firm risk adjustment, because it is simply inapplicable to BVWC, a subsidiary of APT.³³
13 Based on the arguments in its Initial Closing Brief and those above, RUCO urges the
14 Commission to deny the Company's request for a 10.5 percent cost of equity capital and to
15 adopt its generous cost of equity of 9.0 percent.

16 **C. The Company's Hook-up Fee ("HUF") tariff language should be denied.**

17 RUCO incorporates by reference the arguments it made in its Initial Closing Brief in
18 opposition to the Company's proposed HUF tariff permitting the Company to delay recognizing
19 Contributions In Aid of Construction ("CIAC") until plant to which the payments are attached is
20 placed in service.³⁴ RUCO supplements its argument to address the Company's assertion that

22 ³² Company's Closing Brief at 54.

23 ³³ See Exhibit R-8 Surrebuttal of William A. Rigsby at 15-20.

24 ³⁴ RUCO's Initial Closing Brief at 34-35.

1 RUCO's objection to the HUF tariff as worded was based solely on a desire to lower rates.³⁵
2 Even if that were true, so what? RUCO is not in the business of advocating for higher rates for
3 its constituency when lower rates are appropriate. Nonetheless, lower rates are not the sole
4 motivation for RUCO's objection. RUCO objects to the proposed language because it: 1.) is
5 inconsistent with NARUC Guidelines requiring cash payments of CIAC to be recognized on
6 receipt, 2.) represents an unacceptable deviation from Commission precedent and 3.) imposes
7 an unreasonable burden on RUCO and Staff to chase CIAC from case to case.³⁶ Staff
8 concurs. For these reasons and those set for in RUCO's Initial Closing Brief, RUCO requests
9 that the Commission deny the Company's proposed HUF language.

10 RESPECTFULLY SUBMITTED this 29th day of October, 2010.

11
12
13 
14 Michelle L. Wood
15 Counsel

16 AN ORIGINAL AND THIRTEEN COPIES
17 of the foregoing filed this 29th day
18 of October, 2010 with:

19 Docket Control
20 Arizona Corporation Commission

21 ...
22 ...

23 ³⁵ Company's Closing Brief at 59-61.
24 ³⁶ RUCO's Initial Closing Brief at 34-35.

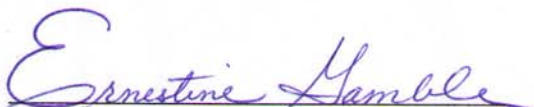
1 COPIES of the foregoing hand delivered/
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