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**BEFORE THE ARIZONA CORPORATION CO...**

COMMISSIONERS
JEFF HATCH-MILLER -- Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

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|---|---|
| IN THE MATTER OF THE APPLICATION OF VALLEY UTILITIES WATER COMPANY, INC. FOR RATE ADJUSTMENTS IN ITS WATER RATES AND FINANCING AUTHORIZATION. | Docket No. W-01412A-04-0736<br>W-01412A-04-0849<br><br>**STAFF'S NOTICE OF FILING WITNESS SUMMARIES** |

Staff of the Arizona Corporation Commission hereby files the Witness Summaries of Dennis R. Rogers of the Utilities Division and Marlin Scott, Jr. of the Engineering Division in the above-referenced matter.

RESPECTFULLY SUBMITTED this 14th day of July, 2005.

David Ronald

David M. Ronald
Attorney, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

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Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

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...

Richard L. Sallquist
SALLQUIST & DRUMMOND
4500 South Lakeshore Drive
Suite 339
Tempe, Arizona 85282
Attorneys for Valley Utilities Water Company

Christopher Kempley, Chief Counsel
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Ernest G. Johnson, Director
Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Lyn Farmer, Chief Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Angela L. Bennett

Angela L. Bennett, Secretary to
David M. Ronald

**VALLEY UTILITIES WATER COMPANY, INC.**
**WATER AND FINANCING APPLICATIONS**
**DOCKET NO. W-01412A-04-0736**
**DOCKET NO. W-01412A-04-0849**
**Summary of Testimony of Dennis R. Rogers**

The direct testimony of Staff witness Dennis R. Rogers addressed the following issues:

Background - Valley Utilities Water Company, Inc. ("Valley" or "Company") is a certificated Arizona based company that provides water utility service to approximately 1,189 customers in Maricopa County, Arizona.

On October 7, 2004, Valley filed an application for a permanent rate increase for its water customers comprised of a two-step phased-in rate increase to provide for adequate operating margins to cover increased capital and operating expenditures necessitated by the Environmental Protection Agency's ("EPA") mandated arsenic reduction requirements from 50 parts per billion ("ppb") to 10 ppb by January 23, 2006. The Company states that it incurred operating income of $13,138 during the Test Year ended December 31, 2003.

On November 26, 2004, Valley filed an application for authority to issue promissory notes and evidences of indebtedness in the original amount of up to $1,926,100. The Company proposes to use the proceeds of the financing to purchase or construct plant and equipment necessary to treat and remove arsenic from water produced by its existing wells.

On March 17, 2005, Valley filed a motion to consolidate the proceedings for the requests for rates and debt authorization citing interrelationships between the filings. On March 23, 2005, a Procedural Order was issued by the presiding administrative law judge granting consolidation.

The Company proposes to phase-in a rate increase of $503,453, or 60.8 percent, in two steps, increasing revenues from $827,565 to $1,331,018. In the first step, the Company requests a $100,784, or 12.19 percent, increase over test year revenues. The incremental step one revenue is intended to cover the proposed WIFA financing. Step one revenues of $928,349 would produce an operating margin of 10.0 percent, or $92,835. The Company proposes a negative $540,691 fair value rate base for step one. In step two, to be issued following the decision, the Company proposes an additional $402,669 revenue increase to cover arsenic treatment operating expenses and an adjustor mechanism with an annual true-up. Step two revenue of $1,331,018 would produce operating income of $133,102 for a 10.7 percent rate of return on a fair value rate base of $1,243,934.

Revenue Requirement – Since the Staff adjusted rate base is negative $539,804, Staff recommends that the Commission authorize a 10 percent operating margin, or $95,751. Staff's recommendation represents a $129,946, or 15.70 percent, revenue increase from

$827,565 to $957,511. Staff's recommended revenue exceeds the Company's proposed step one revenue by $29,162. Staff's recommended rates would increase the typical ¾-inch residential water bill with a median usage of 7,500 gallons, from $28.00 to $31.76, for an increase of $3.76 or 13.45 percent.

Financing - Staff further recommends that the Commission authorize the proposed WIFA loan in the amount of $1,926,100 for the construction of arsenic treatment facilities.

Arsenic Remediation Surcharge Mechanism - Staff further recommends that the Commission approve an Arsenic Remediation Surcharge Mechanism ("ARSM"). The ARSM provides a framework for establishing a surcharge to service new debt and related income tax expense. The ARSM requires the Company to make a separate filing for Commission consideration before a surcharge becomes effective. The ARSM facilitates the Company securing a WIFA loan and estimates the surcharge necessary to service the loan and preserve the Company's cash flow. The ARSM is consistent with the mechanism previously authorized by the Commission in Decision No. 76163, dated August 10, 2003, for Mountain Glen Water Services, Inc. The monthly surcharge for the typical 3/4-inch customer would be approximately $10.06.

Equity - Staff further recommends that the Company file a plan for approval by Staff to progressively increase its equity position on an annual basis until equity represents 40 percent of total capital.

The surrebuttal testimony of Staff witness Dennis R. Rogers addressed the following issues:

Staff responded to Mr. Kozoman's assertion that Staff did not recommend a monthly minimum for construction water sold through 3-inch meters. Staff's Schedule DRR-16, Rate Design, recommends a monthly minimum charge of $179.87 for 3-inch construction water meters.

Staff responded to Mr. Kozoman's observation that the commercial 5/8-inch meter has a different first tier rate than the other classes of customers. Staff has revised Schedules DRR-16 and DRR-17 to correct a typographical error that listed the commercial 5/8- inch meter first tier at $2.30. The corrected figure is $2.31.

Staff responded to Mr. Kozoman's inability to duplicate Staff's revenue requirement. When inputting Staff's rates Mr. Kozoman derives $950,809 rather that Staff's $957,511 for a difference of $6,702. Staff utilized the same bill counts for its recommended revenues that balanced to the Company's original application, annualized revenues, and proposed amounts.

Staff responded to Mr. Kozoman's arguments concerning Staff's rate design pertaining to "Life Line Rates", lack of a cost of service study, and three tiers for the Residential 5/8 –

inch and 3/4 - inch customers while the other classifications have but two tiers. These questions were addressed in both the Arizona American and Rio Rico rate cases. The Commission found that in the case of Arizona American's seven water systems that Staff's rate design was appropriate, and in the Rio Rico decision the Commission adopted a three tier inverted rate structure for the 5/8 –inch residential and commercial customers while maintaining an inverted two tier structure for all other meter sizes and classes that Mr. Kozoman proposed.

Staff responded to Mr. Robert L. Prince's testimony that customers may choose to lower their water bills by downsizing from their 1-inch meter and "over revving" the smaller meter which could impact revenues and expenses. The Company's proposed rate design provides for the same asserted opportunity.

Staff responded to Mr. Bourassa testimony as to what appears to be the main source of disagreement between Staff and the Company. The Company proposes a surcharge mechanism for recovery of estimated arsenic removal operation and maintenance costs. Staff recommends that the Company file another rate case application after the costs become known and measurable consistent with prior Commission decisions.

Staff responded to Mr. Bourassa's statement that the Arsenic Recovery Surcharge Mechanism does not require a subsequent filing by the Company for consideration by the Commission for approval. Staff is recommending approval of the Company's application for financing through the Water Infrastructure Finance Authority ("WIFA") in the form described in its Direct Testimony, Pages 27 and 28. The methodology is consistent with other Accelerated Arsenic Cost Recovery Mechanisms previously authorized by the Commission; please see Ash Fork Water Service, Decision No. 67158 and Mountain Glen Water Service Inc., Decision No. 67163.

Staff responded to Mr. Bourassa's proposal that the Operation and Maintenance Costs associated with the mandated arsenic removal should be recovered by an Arsenic Operating and Maintenance Recovery Surcharge Mechanism ("AOMRSM"), which the Company will only incur actual costs. Staff recommends that the surcharge mechanism be disallowed and that the Company file a rate case application after a period of time has elapsed so that the actual operation and maintenance costs can be determined and the appropriate rates established. Mr. Bourassa acknowledges that the costs, although a reasonable estimate, are projected.

Staff responded to Mr. Bourassa's inclusion of refunds of Advances in Aid of Construction ("AIAC") in the Company's calculation of Debt Service Coverage ("DSC"). Staff acknowledges the difference in the methodologies used by the Company and Staff. Staff has revised Schedule DRR-21 to show both methodologies.

Staff responded to Mr. Bourassa's observation that Staff incorrectly overstates income tax expense. Staff agrees with Mr. Bourassa. Schedule DRR-21, Column [D], With WIFA Loan, did not reduce income tax expense because of the interest expense associated with the WIFA loan. Staff has reduced income tax expense in Column [D] by

$39,420, from $54,262 to $14,842. This has no effect on Staff recommended rates or Staff's recommended authorization and method of handling the WIFA financing application

**SUMMARY OF PRE-FILED TESTIMONY**
**BY MARLIN SCOTT, JR.**
**FOR**
**VALLEY UTILITIES WATER COMPANY, INC.**
**DOCKET NO. W-01412A-04-0736**
**&**
**DOCKET NO. W-01412A-04-0849**

## CONCLUSIONS

A. The Valley Utilities Water Company, Inc. ("Company") has a water loss of 1.96% which is within acceptable limits.

B. The Company's current well source and storage capacity are adequate to serve the present customer base and reasonable growth.

C. The Maricopa County Environmental Service Department ("MCESD") has reported no major deficiencies and based on data submitted to MCESD, MCESD has determined that the Company's system, PWS No. 07-079, is currently delivering water that meets water quality standards required by the Arizona Administrative Code, Title 18, Chapter 4.

D. The Company reported the arsenic concentrations for its Well No. 1 at 12 ppb, Well No. 2 at 12 ppb, Well No. 3 at 7 ppb, Well No. 4 at 12 ppb, Well No. 5 at 13 ppb and Well No. 6 at 11 ppb. The Company has submitted a financing application, under Docket No. W-01412A-04-0849, requesting financing approval to purchase and construct water treatment facilities for arsenic removal. (See RECOMMENDATION No. 6.)

E. The Company is located in the Arizona Department of Water Resources Phoenix Active Management Area ("AMA") and is in compliance with AMA water use and monitoring requirements.

F. The Company has no outstanding Arizona Corporation Commission compliance issues.

## RECOMMENDATIONS

1. Staff recommends its average annual cost of $4,014 be adopted for the water testing expense in this proceeding.

2. Staff recommends that $1,883,600 of reported post-test year plant items not be included in rate base.

3. Staff recommends that the Company use the depreciation rates by individual National Association of Regulatory Utility Commissioners category presented in Table I-1 on a going forward basis.

4. Staff recommends the acceptance of the Company's proposed service line and meter installation charges.

5. Staff recommends that the Company file a Curtailment Plan Tariff in the form of Attachment K-1. This tariff shall be docketed as a compliance item in this case within 45 days of the effective date of an order in this proceeding for review and certification by Staff.

6. Staff concludes that the arsenic treatment facilities being proposed in the financing application are appropriate and recommends the estimated capital costs ($1,926,100) and operation & maintenance costs ($216,600) be used for purposes of the financing request.