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BEFORE THE ARIZONA CORPORATION COMI

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTEN K. MAYES
Commissioner

Arizona Corporation Commission
DOCKETED

MAY 25 2005

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IN THE MATTER OF THE APPLICATION OF) DOCKET NO. W-01445A-04-0650
ARIZONA WATER COMPANY, AN)
ARIZONA CORPORATION, FOR) NOTICE OF FILING
ADJUSTMENTS TO ITS RATES AND) SURREBUTTAL TESTIMONY OF
CHARGES FOR UTILITY SERVICE) EDWARD F. HARVEY
FURNISHED BY ITS WESTERN GROUP)
AND FOR CERTAIN RELATED)
APPROVALS)

The City of Casa Grande hereby gives notice that the Surrebuttal Testimony of Edward F. Harvey is attached and has been filed this same date.

Dated this 25th day of May, 2005.

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IN THE MATTER OF THE APPLICATION) DOCKET NO. W-01445A-04-0650
OF ARIZONA WATER COMPANY, AN)
ARIZONA CORPORATION, FOR)
ADJUSTMENTS TO ITS RATES AND)
CHARGES FOR UTILITY SERVICE)
FURNISHED BY ITS WESTERN GROUP)
AND FOR CERTAIN RELATED)
APPROVALS)
_____)

SURREBUTTAL TESTIMONY

OF

EDWARD F. HARVEY

ON BEHALF

OF

THE CITY OF CASA GRANDE

MAY 25, 2005

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1 **I. INTRODUCTION AND PURPOSE OF TESTIMONY**

2
3 **Q. PLEASE STATE YOUR NAME AND ADDRESS**

4 A. My name is Edward F. Harvey. My business address is 600 South
5 Cherry Street, Suite 220, Denver, Colorado 80246.

6
7 **Q. ARE YOU THE SAME EDWARD F. HARVEY THAT PREVIOUSLY PROVIDED**
8 **DIRECT TESTIMONY IN THIS MATTER?**

9 A. Yes I am.

10
11 **Q. HAVE YOU REVIEWED THE DIRECT TESTIMONY AND THE REBUTTAL**
12 **TESTIMONY FILED BY THE OTHER PARTIES TO THIS PROCEEDING?**

13 A. I have reviewed the direct testimony of the Arizona Corporation Commission
14 (Commission or Staff) and Residential Utility Consumer Office (RUCO) witnesses. I
15 have also reviewed the rebuttal testimony of the Arizona Water Company (Company)
16 witnesses.

17
18 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

19 A. The purpose of my surrebuttal testimony is to respond to certain issues raised in the
20 rebuttal testimony of the Company, and the direct testimony offered by Staff and the
21 RUCO witnesses.

22
23 **II. CENTRAL ARIZONA PROJECT M&I DEFERRED CAPITAL PAYMENTS**

24
25 **Q. DO YOU AGREE WITH THE COMPANY REBUTTAL TESTIMONY REGARDING**
26 **THE COST RECOVERY OF DEFERRED CAPITAL PAYMENTS OF CENTRAL**
27 **ARIZONA PROJECT (CAP) M & I WATER?**

28 A. No, I do not. Because Casa Grande's unused allocation of CAP water has not been
29 used by current customers, deferred CAP M&I costs associated with that allocation
30 should not be paid by current customers. The City of Casa Grande recommends
31 that the Commission reject the Company's proposed 10-year amortization of the
32 deferred CAP charges and its request for rate base treatment of those expenses.
33 Further, until the Company has prepared a water resource plan and coordinated with

1 the City of Casa Grande in preparing and implementing that plan, any request by the
2 Company for recovery of deferred CAP M&I water expenses should be denied.
3

4 **Q. THE COMPANY HAS TESTIFIED THAT IT MEETS THE CAP COST RECOVERY**
5 **CRITERIA AS ARTICULATED IN A PRIOR DECISION BY THE COMMISSION.**
6 **DO YOU AGREE?**

7 A. In its rebuttal testimony, the Company states that it has complied with the four criteria
8 for CAP M&I expenses related to a previous Commission order (although not directly
9 ordered by the Commission itself):

- 10 1. The CAP allocation is needed to properly serve its customers.
- 11 2. Such need would occur by the year 2025.
- 12 3. Use of a reasonable amount of its allocation must occur by 2025.
- 13 4. All of the allocation must be used by 2034.

14 Regardless of whether or not the above four criteria represent Commission policy,
15 the Company has not met these criteria. We have no proof that CAP is really
16 needed, by what date and by whom. The Company has only offered representations
17 that it needs the water and by when. Further, no justification or detailed explanation
18 of its engineering plans has been offered.

19
20 The Company has not prepared and submitted a complete water resource plan and
21 a complete water master plan justifying its infrastructure development plans. The
22 water resource plan is a study commonly employed by municipal water providers that
23 provides an objective evaluation of the present and future water resource
24 alternatives and compares those with carefully developed water demand projections.
25 This comparison, along with costs, leads to a plan for water resource deployment.
26 The water master plan spells out the costs for developing the infrastructure to
27 support the water resource plan. These studies are reviewed in an open forum so
28 that the ratepayers and affected communities can scrutinize the assumptions to build
29 support for the plan they will eventually fund. This type of planning effort is typical for
30 municipal water providers and should be considered essential when they are faced
31 with major capital outlays and considerable future growth, precisely the
32 circumstances found in Casa Grande in 2005.
33
34

1 The prospect of a regional CAP treatment plant to serve Casa Grande and multiple
2 communities, raised by a Company's witness in rebuttal, is an example of how not to
3 accomplish such planning. Affected parties should have already been brought into
4 the planning process so that assumptions are clear and those who will be served are
5 not left guessing how this will work and why this is the best path. In fact, the
6 arguments put forth by Staff and RUCO for denying CAP capital cost recovery stem
7 from the inadequate, non-inclusive planning process which the Company has
8 followed.

9
10 Without such studies, the Company cannot establish that it has met any of the four
11 criteria that it has articulated as necessary preconditions to CAP cost recovery. As
12 part of the discovery process in this case, the Company responded to the City of
13 Casa Grande that it had not performed these studies. Without this planning effort,
14 the Company should not receive any CAP M&I cost recovery for the unused portion
15 of the CAP allocation.

16
17 **Q. DO YOU AGREE WITH THE COMPANY THAT WATER RESOURCE PLANNING**
18 **SHOULD NOT BE CONSIDERED IN THIS HEARING PROCESS?**

19 **A.** I do not agree. The costs of arsenic treatment, according to scenarios prepared by
20 the Company and offered during discovery, could raise Casa Grande rates by as
21 much as 47%. Based upon exhibits offered by the Company in rebuttal, the CAP
22 cost recovery plan proposed by the Company might raise rates by almost 8% *before*
23 operation and maintenance costs and the new \$20 million treatment plant are paid
24 for. These two prospects alone will create major impacts on Casa Grande, but the
25 City's only opportunity to raise questions, much less be involved in the planning
26 process is through this rate proceeding. The Company now says that it lacks
27 sufficient time to do such planning. The Company's refusal to plan in advance of this
28 rate case proceeding cannot release the Company from its important obligation to
29 prepare a thorough water resource plan. Indeed, this rate case may be the
30 Commission's only opportunity to leverage compliance with a directive to complete a
31 water resource plan.

1 **Q. WHY DON'T YOU AGREE WITH THE COMPANY THAT THE UNUSED PORTION**
2 **OF CASA GRANDE'S ALLOCATION OF CAP WATER BENEFITS EXISTING**
3 **CUSTOMERS?**

4 A. The existing Casa Grande customers are not required to stop using groundwater. As
5 the Company witnesses state in their rebuttal testimony, the Pinal AMA does not
6 mandate safe yield, nor does it require existing groundwater users to convert to
7 surface water. Moreover, the deployment of CAP water will very likely be a financial
8 disadvantage to existing Casa Grande customers. Groundwater is relatively less
9 expensive than CAP water due to the difference in capital and operating costs as
10 well as the higher treatment costs associated with CAP water.

11
12 The Company suggests that existing customers benefit because new subdivisions
13 can claim a 100 year assured water supply, but this benefit accrues almost entirely to
14 land developers and new customers within those developments. The past
15 deployment of CAP water for non-potable users did not benefit existing customers
16 who had alternatives; it allowed for eventual groundwater use by future customers.
17 Clearly, the deployment of CAP in Casa Grande is intended to meet the *incremental*
18 water needs of future customers.

19
20 The blending of CAP water is not a benefit to existing customers who must soon ante
21 up substantial monies for arsenic treatment costs. The Company indicates in its
22 rebuttal testimony that substituting CAP resources to relieve this problem is
23 impractical.

24
25 **Q. WHAT SIGNIFICANCE DOES THAT FACT HAVE IN THIS CASE?**

26 A. The existing Casa Grande customers would be subsidizing the future water users if
27 they paid any deferred CAP capital costs. Like many cities today, the City of Casa
28 Grande has a policy that growth must pay its own way.

29
30 **Q. CAN YOU SUMMARIZE YOUR OPINION AND RECOMMENDATIONS**
31 **REGARDING CAP WATER AND RELATED CHARGES?**

32 A. My opinion is that the unused CAP water does not meet the used and useful test as
33 described by Staff and RUCO in their direct testimony. Further, the Company needs
34 to initiate a proper, inclusive water planning process in Casa Grande which

1 culminates in a deployment plan for CAP and other water resources. Following
2 acceptance of that plan, the Company should propose a capital cost recovery plan
3 focusing on new users in the form of a hook-up or water resource fee. These monies
4 should be gathered and used to pay-off deferred CAP capital costs on a pass-
5 through basis without Company enrichment.

6
7 **Q. DO YOU SUPPORT STAFF RECOMMENDATIONS REGARDING THE**
8 **REVISIONS TO THE NP-260 RATE SCHEDULE?**

9 A. Yes, I do.

10
11 **III. ARSENIC COST RECOVERY**

12
13 **Q. ARE YOU SATISFIED THAT THE COMPANY HAS DONE ENOUGH TO SEEK**
14 **FINANCIAL ASSISTANCE WITH THE ARSENIC RECOVERY EFFORT**
15 **CONTEMPLATED FOR CASA GRANDE?**

16 A. No, I am not. According to the Company's rebuttal testimony, they had one meeting
17 with the Water Infrastructure Finance Authority (WIFA) and performed an internet
18 search. This one meeting and modest search project likely amounted to less than a
19 day's effort versus a looming \$12 million expenditure facing Casa Grande. The
20 Company has no incentive to help reduce these costs, and its effort demonstrates
21 that.

22
23 **Q. CAN YOU CITE A SPECIFIC INSTANCE WHERE THE COMPANY'S APPROACH**
24 **TO OBTAINING FINANCIAL SUPPORT IS LACKING?**

25 A. The difficulty expressed by the Company in meeting the WIFA requirements is a
26 good example. The Company says that WIFA is not designed for a multiple system
27 utility, and that it could not comply with the requirements. If asked by the Company,
28 the City of Casa Grande could take the lead role here and could attempt to secure
29 support for the project in a public-private partnership. The Company's insular
30 approach will result in unnecessarily higher costs to Casa Grande ratepayers; a
31 more cooperative effort is in the best interest of Casa Grande water users.

1 **IV. RISKS FACING ARIZONA WATER COMPANY**

2
3 **Q. THE COMPANY CONTINUES TO MAINTAIN THAT IT FACES SPECIAL RISKS**
4 **WHICH WARRANT AN UPWARD ADJUSTMENT IN ITS RATE OF RETURN. DO**
5 **YOU AGREE?**

6 A. No, I do not. First, the inverted rate block structure cannot be viewed as undue risk
7 since so many water utilities rely on this approach. About one third of the utilities
8 listed in the WIFA database employ inverted block rate structures. Second, the
9 contention that comparable utilities do not face the same risks is misleading;
10 comparable utilities likely have their own special risks. Comparability in this instance
11 is weak given the differences between water companies, and any comparison is
12 difficult to establish with a privately held company. Third, there is no basis for
13 presuming that the magnitude of the risks cited by the Company rise to the attention
14 of the investment community. Based on discovery, no investment analyst or financial
15 institution has examined the Company since 1993. No major buyer or seller of
16 company stock has stepped forward in that period, either.

17
18 **V. PURCHASED POWER/WATER ADJUSTMENTS**

19
20 **Q. THE COMPANY MAINTAINS THAT IT IS ENTITLED TO A PURCHASED POWER**
21 **AND PURCHASED WATER ADJUSTMENT BECAUSE THOSE ITEMS ARE OUT**
22 **OF ITS CONTROL. DO YOU AGREE?**

23 A. No, I do not. For a cost to be out of the Company's control, that would suggest that
24 there are no alternatives, that there is one and only one supplier or resource and the
25 potential for great price fluctuation. The Company has not proven that this is the
26 case. For example, if water can be obtained from several sources, the price paid by
27 the Company is not completely out of its control.

28
29 **Q. DO YOU AGREE WITH STAFF'S POSITION ON THIS MATTER?**

30 A. Yes.

31
32
33
34

1 **VI. RATE DESIGN**

2
3 **Q. ARE THE COMPANY'S ARGUMENTS CONCERNING INVERTED BLOCK RATE**
4 **STRUCTURES INCONSISTENT?**

5 A. Yes, they are. The Company maintains in its direct and rebuttal testimony that there
6 is insufficient evidence that inverted rate structures conserve water. At the same
7 time, the Company says that the price elasticity of water will result in an unstable
8 revenue structure. Belief in price elasticity is contrary to a belief that inverted rate
9 structures do not result in conservation.

10
11 **Q. WHAT DOES IT TELL YOU ABOUT THE COMPANY'S POSITION ON RATE**
12 **DESIGN WHEN THERE IS NO COST OF SERVICE STUDY?**

13 A. The Company's complaints about Staff and RUCO proposals should carry no weight.
14 First, the Company proposed a rate design with essentially no basis, deaf to
15 conservation incentives, and fraught with inequity. Now in rebuttal, it accuses Staff
16 and RUCO of a failure to fully support their alternative rate designs. The Company
17 has no foundation to weigh-in further on this issue.

18
19 **Q. WHAT ARE THE IMPLICATIONS OF THE ABSENCE OF A COST OF SERVICE**
20 **STUDY?**

21 A. I share the Company's newfound concern about a lack of a cost of service study.
22 The implications of this are that an overall cost of capital might be determined in this
23 case, but without a proper basis for implementing it by customer type, by meter size
24 and by rate block, the rate increase should not be implemented, regardless of need.

25
26 **Q. WHAT IS YOUR OPINION ABOUT THE COMPANY'S CALCULATION OF**
27 **ELASTICITY FOR THE EASTERN GROUP?**

28 A. I believe the Company's calculation is flawed. A year to year comparison must
29 reflect adjustments for all factors which influence demand, not the least of which is
30 weather, to isolate the rate structure effect. A one year comparison is also
31 insufficient. Because the Company's calculation does not identify and control
32 multiple factors over a term of years, it is not useful in this instance.

1 **Q. HAVE YOU REVIEWED THE COMPANY'S EXHIBIT WITH RESPECT TO THE**
2 **ELASTICITY ASSUMPTION?**

3 A. Yes, I have. Price elasticity is much more complicated than simply assigning a
4 number, *a priori*, to a real world circumstance. Past studies, including the one cited
5 by the Company, point to a wide range of elasticity results. This reflects the fact that
6 the exact circumstances surrounding the price change by a water utility determines
7 demand response. For example, how big is the price change? How high is the base
8 price? What are the socioeconomic conditions of the ratepayers? The Company's
9 position on this issue is speculative.

10
11 **VII. REIMBURSEMENT OF LEGAL EXPENSES**

12
13 **Q. WERE YOU SURPRISED BY THE COMPANY'S POSITION AND ATTITUDE**
14 **REGARDING ITS EFFORT TO OBTAIN REIMBURSEMENT FOR PAST LEGAL**
15 **MATTERS PERTAINING TO THE CITY OF CASA GRANDE?**

16 A. Yes, I was quite surprised by the characterization, or rather the damnation, of the
17 City of Casa Grande in the language employed by the Company in its rebuttal
18 testimony. The disparaging picture of the City is disrespectful to the City, its citizens
19 and this rate process. Beyond the descriptive language, the Company suggests that
20 it was the protector of the Casa Grande water customers in the face of efforts by the
21 City that were contrary to the interests of its own citizens. Of course, there are two
22 sides to this story, neither of which is relevant for purposes of evaluating the
23 Company's rate application.

24
25 **Q. WHAT IS THE MERIT OF THE COMPANY'S CLAIM FOR REIMBURSEMENT OF**
26 **ITS LEGAL EXPENSES IN THE TWO CASA GRANDE CASES?**

27 A. None. The Company was merely protecting its assets and business interests, as
28 would any firm facing an outside threat. The legal expenditures were solely to
29 benefit shareholders. The ratepayers received no clear benefit from these Company
30 expenditures; it is at least arguable that the reverse is true. The theory the Company
31 is applying here has a vindictive, punitive nature. Casa Grande must pay for
32 questioning Arizona Water Company actions.

1 **Q. DO YOU AGREE WITH STAFF AND RUCO POSITIONS ON THIS MATTER?**

2 A. Yes, I do.

3

4 **Q. IS THIS THE PROPER FORUM FOR THE COMPANY TO PURSUE SUCH A**
5 **CLAIM?**

6 A. No, it is not.

7

8 **Q. DOES THAT CONCLUDE YOUR TESTIMONY?**

9 A. Yes, it does, although my silence on other matters does not indicate my agreement
10 with them, and I reiterate and reassert my direct testimony.

11