

ORIGINAL



0000024161

OSRB

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER

Chairman

WILLIAM A. MUNDELL

Commissioner

MARC SPITZER

Commissioner

MIKE GLEASON

Commissioner

KRISTIN K. MAYES

Commissioner

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
WESTERN GROUP AND FOR CERTAIN
RELATED APPROVALS

) DOCKET NO. W-01445A-04-0650
)
)
)
)
)
)
)
)
)
)
)

REPLY BRIEF OF THE CITY OF CASA GRANDE

AZ CORP COMMISSION
DOCUMENT CONTROL

2005 AUG 22 P 3:24

RECEIVED

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
I. Water Resource Master Plan (“WRMP”)	2
A. The Detail Included in the WRMP is Necessary	2
B. The WRMP Cost is a Modest, Valuable and Recoverable Investment	4
C. CAP Monies Should be Conditioned on Completion of the WRMP.....	5
D. City Input in the WRMP Process.....	6
II. Litigation Expenses.....	8
III. Additional Issues.....	11
A. Cost of Capital	11
1. Several Factors Decrease the Risk Associated with Investing in Arizona Water Company	12
2. The Company Is Not Subject to Any “Special Risks” Justifying a Risk Premium.....	13
B. Implementing a Multi-Tiered Rate Design Promotes Commission Policy	15
C. An Elasticity Adjustment Is Not Warranted At This Time.....	15
D. The Purchase Power and Water Adjustment Mechanisms Should be Eliminated	16
CONCLUSION.....	17

INTRODUCTION

The City of Casa Grande (“the City of Casa Grande” or “the City”) continues to believe that adequate planning for future water development and delivery by the Arizona Water Company (“the Company” or “Arizona Water Company”) is the most critical issue presented in this case. If, through a failure to adequately plan, the Company underestimates water supply and delivery needs, it will not be possible to plan “doubly hard” the next year and achieve the same outcome at the lowest possible long-term cost. For example, if a ten-year plan would have suggested ways to make use of CAP water for non-potable uses (rather than through treatment), that opportunity for cost savings is lost once the Company invests in the construction of a stand-alone CAP treatment facility. Water supply, capital investment and operational planning failures by the Arizona Water Company will not be easily or efficiently remedied. A Water Resource Master Plan (“WRMP”), conducted openly with full and timely input from affected parties, is the only sure way to choose wisely among possible water supply and development alternatives, thereby insuring the delivery of high quality water at the lowest long-term cost to the customers, a goal the Company supports according to hearing testimony offered by its officials. (Tr. at 390).

This Reply Brief addresses questions raised in closing briefs regarding the WRMP, responds to arguments regarding the Company’s claim for legal fees, and comments briefly on other revenue related issues addressed by the parties.¹

¹ Counsel for the City mistakenly designated the first post-hearing brief, filed August 1, 2005, as the City’s “Opening Brief.” To be consistent with the other briefs filed that same date, we will refer to that brief in this reply as the City’s “Closing Brief.”

I. Water Resource Master Plan (“WRMP”)

The Company’s Closing Brief accurately summarizes the City’s position: The City opposes recovery of CAP M&I capital charges until a WRMP is prepared and it expects “real-time” input into the preparation of the master plan. (*See Company Closing Brief at 15-16.*) These requests are both reasonable and necessary. Preparation of a water resource master plan is standard operating procedure for a water utility serving a community such as Casa Grande. (*See CCG-4, 5 and 6 (illustrative water resource master plans prepared for Goodyear, Surprise, and Avondale)*). Arizona Water Company, by all accounts will serve three times as many customers by 2020 in the Western Group alone. *See Rebuttal Testimony of William Garfield at 11; Tr. at 424-426.* In its Closing Brief, the Company offers no explanation for why, to the detriment of its ratepayers, it has been operating for years without a water resource master plan.

In opposing the preparation of a WRMP, the Company argues that the WRMP is too detailed, vague, and that it would be more costly than the Central Arizona Project Water Use Plan (“CAPWUP”) recommended by Staff. These assertions stem from a lack of understanding of the two proposed plans.

A. The Detail Included in the WRMP is Necessary

The WRMP includes in each subsection a general roadmap for how information will be gathered. This detail is yet to be written for the CAPWUP. For the CAPWUP to be implemented, however, the detail supporting each requirement will have to be developed. By way of example, Section (1) of the CAPWUP and Section I of the WRMP both ask for current water use information. The descriptions used for the two sections – “Existing water supplies and demand patterns” – are identical. The WRMP, however, requires specific information describing the data that must be gathered to evaluate current water supplies and demands. As Mr. Olea

testified, with a handful of exceptions, the supply data that is specifically required by WRMP Section I, is also necessary and, as he interprets the CAPWUP, impliedly included in CAPWUP Section 1. “Just what Staff would be looking for would be water demand in general . . . peak use and the monthly demand patterns . . . not only the water sold but the water pumped.” (Tr. at 1209)² In the CAPWUP, however, the specific information to be gathered is not identified. As a result, reasonable disagreement and confusion are likely as varying interpretations emerge for what each CAPWUP heading actually requires.

The detail included in the WRMP will ensure that all important information is captured. The availability, cost, and constraints pertaining to potential water supplies other than CAP are examples of the detail needed in such a plan. If the potential for acquiring additional supplies or making more use of non-potable water is not addressed, the credibility of the final plan could be questioned by the rate-paying public, undermining the support for CAP development. A thorough water resources plan, which gives due consideration to reasonable demand, supply, cost and implementation issues, will be more helpful and useful to the Company, and to the City, than a plan that captures only a portion of the relevant data.

Like Section 1, Sections 2-5 of the CAPWUP can be interpreted to include the bulk of the information required by Sections II through VII of the WRMP. (Tr. at 1209-1210.)³ The

² The differences between the two sections are few: (1) the WRMP calls for five years of historic data, the CAPWUP goes back two years; (2) the WRMP asks for annual sales, the CAPWUP does not; and (3) the WRMP requests water quality information and the condition of wells and the CAPWUP does not.

³ Mr. Olea indicated some confusion regarding the “constraints and opportunities” sub-part in sections III-VII. As Mr. Harvey testified during the hearing this sub-part is intended to capture any limits on the use of a particular water resource. (Tr. at 837.) For example, cost and water production data might support use of a particular groundwater well, but arsenic levels (a constraint) would foreclose such use. Opportunities encompass similar, but positive, incentives for opting to use a particular water resource.

WRMP however is more specific. It is not vague or uncertain as alleged by the Company, rather it is more detailed and specific than the CAPWUP, thereby leaving less room for ambiguity or misunderstanding.

The WRMP and the CAPWUP differ substantively in one important respect. The WRMP contains Section VIII, titled "Recommended Water Master Plan," while the CAPWUP contains no such culminating plan requirement. (*Compare CCG-7 with SMO-4 (Attachment A).*) Section VIII of the WRMP requires the Company to describe and justify the future water supply plan that it has chosen and set forth a cost schedule for implementing that plan. Importantly, this supply plan would consider and include all available water resources, not only CAP water. The CAPWUP sections 2 and 4 could be read to include a recommended plan for all water resources, but this is not expressly required and, once again, could lead to confusion. Bringing together in Section VIII of the WRMP the different components of the water resource planning effort into a composite plan for the future (as a clear, explicit roadmap for all to see) is an indispensable element. This culmination is the payoff of the WRMP. The level of planning detail contained in the WRMP will best protect Arizona Water Company ratepayers.

B. The WRMP Cost is a Modest, Valuable and Recoverable Investment.

The Company argues that the expense associated with a WRMP is grounds for rejecting such a plan. (Company Closing Brief at 16.) That assertion is penny-wise and pound-foolish. Mr. Harvey estimated that *if* all major elements of the WRMP were contracted out (an unlikely scenario given the Company's in-house expertise) the cost would be in the range of \$80,000-120,000. (Tr. at 947.) Mr. Olea testified that he fully expected that the data gathering and analysis required for evaluating water resources could be completed by Mr. Whitehead. (Tr. at 1200.) Because a substantial portion of the plan preparation work could be completed in-house,

the cost associated with the plan would be substantially less than Mr. Harvey's initial estimate of \$80-120,000.⁴ Even accepting that the cost might be in the range of \$80,000-120,000, this investment in water resource planning is minor when set against the large anticipated capital expenditures facing the Company – including \$20 million for a CAP treatment facility (Tr. at 838) and \$13.6 million for arsenic treatment (Direct Testimony of William Garfield at 7). The cost for poor planning, or even sub-optimal planning, can be tremendous – as witnessed in the stranded costs which electric and other utilities face periodically. Indeed, a ratepayer would likely be surprised to learn that the Company was contemplating significant investments without first preparing an overall plan for water resource development.

The City agrees that the Company should be permitted to recover (ultimately from ratepayers) the cost of this investment in planning. Investing for planning, however, is the norm in the utility industry, not the exception. (*See, e.g.*, Tr. at 878 noting that developing a water resource master plan is “quite common for power companies, for natural gas companies. And . . . it is very common for water utilities”; Exhibits CCG-4, CCG-5, and CCG-6 water resource master plans for the cities of Surprise, Avondale, and Goodyear.) Ultimately, ratepayers are well-served by careful planning that aims at achieving the lowest, long-term rates for customers.

C. CAP Monies Should be Conditioned on Completion of the WRMP

The City submits that recovery of deferred CAP M&I charges should be conditioned on approval of the WRMP by Staff. The Company opposes linking CAP M&I recovery to water resource development planning. However, for years, the City has been concerned that the

⁴ After taking into account the Company's in-house expertise, any additional cost associated with a WRMP would be modest. Furthermore, the incremental cost would create incremental benefit for the Company and ratepayers in the form of a more thorough water resource plan.

Company has not engaged in serious long-term water resource planning. In a letter submitted by the City to the Company in 1999, the City expressed its concern that the Company was not “working toward long-term water resource solutions” and noted the absence of any “plans to bring renewable water sources into the community.” (See Ex. A-22.) The following years brought contentious litigation but, unfortunately, little long-term planning. Now, six years later, with large population growth at the city’s doorstep, a water resource plan still does not exist despite the plan and immediate need for such a plan. The City fears that without an obligation to prepare and submit a plan to an outside body, the Company will turn to other pressing, short-term obligations and preparation of the WRMP will be delayed indefinitely. (Tr. at 873-74.) For this reason, the City requests that the Company’s recovery of water resource development costs (CAP M&I capital charges) be linked to preparation and approval of a WRMP. As soon as the Company has prepared a WRMP – and has a clear plan for how CAP water fits into that plan going forward – the Company should be allowed to immediately begin collecting money to reduce the accumulated CAP M&I capital account through the hookup fee proposal recommended by Staff.

D. City Input in the WRMP Process

The Company alleges in its Closing Brief that the City wants “the right to participate in Arizona Water’s business decisions.” (Company Closing Brief at 16.) This is incorrect and mischaracterizes the City’s testimony in this proceeding. (See, e.g., City Closing Brief at 11-12; Tr. at 923-926, 958-59.) In fact, the City has been extremely careful throughout this process to respect the Company’s autonomy. (See, e.g., 923-926 (explaining that “it would be improper” for the City to initiate contact with the Company regarding partnering ideas, as the Company is responsible for making all business decisions and the City must “be careful about usurping the

company's roles and responsibilities").) And, as the City has said repeatedly, the WRMP has nothing to do with the 1999 condemnation litigation that was resolved many years ago. (*See generally, e.g.*, Tr. at 887 (discussing how what happened in 1999 is not relevant to 2005, as "[t]here is a different group [managing Casa Grande now]. I think it is far more constructive to look forward with the current players than it is to look backward"). A WRMP will help the Company succeed, a goal publicly embraced and promoted by the City throughout this proceeding. (*See, e.g.*, City Closing Brief at 3-12; Tr. at 858 ("We appreciate the hard work and the services that the company has provided in the past. And we look forward to working with them in the future.") and 890 ("The City of Casa Grande does not view [the WRMP] as a threatening document but an opportunity to develop a plan, work together on the plan and move forward.").)

As the City and the Company move forward with preparing a WRMP, the City has acknowledged that Company management has a right to disagree with suggestions made by the City. (Tr. At 882.) This right to disagree, however, is not license to exclude the City from any stage of the WRMP process. Real-time input by the City during the design and preparation of the WRMP (or the CAPWUP) can occur without interference with the Company's business decisions. Mr. Olea testified in support of allowing the City this sort of real-time input:

the Company [should] seek input from the cities as to any ideas the cities might have or you know, whatever input the city could give to the company that would help the company better plan what it is going to do. Because I am sure the city has, you know, some estimates on what growth is going to be or if they plan to expand their boundaries or whatever, or if the city is going to plan to expand their boundaries . . . I think the company has to work with the city to come up with a proper plan.

(Tr. at 1214.)

It is the City's position that everyone, including the Company, will be well-served by a planning process that encourages active participation by affected parties. (Tr. at 882-883 ("[I]n the end,

when the water company is moving forward . . . with major investments, the likelihood of having some resistance or some concern, or some effort at condemnation and a major controversy is certainly reduced by having [the City participate].”) The benefits to the Company from the City’s active participation would be numerous. For example, the City is in the best position to inform the Company of its current plans for expansion and estimates for growth. Also, the City can direct the type and location of new industrial growth with information supplied by the Company concerning the availability of water. Meaningful and timely input from the City will be indispensable to good planning and good planning will be the only way to adequately serve the existing ratepayers and future customers. The City’s active participation will help ensure that reasonable input is considered. This cannot help but result in a better plan, and a better plan serves the interest of the Company as well as the ratepayers.

II. Litigation Expenses

Staff, RUCO, and the City have extensively briefed why, under the law, the Company is not allowed to recover certain litigation expenses either in rate base or as operating expenses. (See Staff Closing Brief at 8-11; RUCO Closing Brief at 3-9; and City Closing Brief at 15-22.) Therefore, the City limits its reply to a few critical issues not addressed by the Company, or not supported by sufficient evidence.

The Company’s most obvious omission is its failure to address why the *non-recurring* legal expenses at issue should be given rate base treatment. Non-recurring legal expenses should never be included in rate base, which allows for recovery in perpetuity. (See, e.g., *Gulf State Utils. Co. v. La. Pub. Serv. Comm’n.*, 676 So. 2d 571, 579-80 (La. 1996) (disallowing recovery of legal expenses in rate base because, among other things, they were “unusual and not likely to recur”).) The Company responds to this argument by asserting that “[n]o other party suggested

an alternative means of booking” the expenses. (Company Closing Brief at 20.) This is incorrect; RUCO provided an alternative means of booking these expenses in its pre-filed testimony. (*See Direct Testimony (Revenue Requirements) of William A. Rigsby at 24*) (stating that the expenses should have been included as non-recurring operating period expenses); (*Surrebuttal Testimony of William A. Rigsby at 17 (same).*) The Company offers no sound basis for including the expenses. Indeed, there is none.

Had the Company tried to recover its legal expenses as operating expenses, even this argument would have failed the test for such recovery. The law provides four guidelines to be considered: (1) if the fees were reasonable and necessary for the utility to provide services; (2) if the underlying legal proceeding will provide benefits to ratepayers; (3) if the legal expenses were incurred in good faith; and (4) the actual outcome of the litigation and whether the legal expenses could have been avoided through prudent management. *See Ex rel. Utils. Comm’n and Glendale Water, Inc.*, 343 S.E.2d 898, 907 (N.C. 1986). Here, as explained in the City’s Closing Brief at 17-21, the record evidence shows that three of these four guidelines counsel against awarding fees.

Without evidence supporting recovery under these guidelines, the Company instead offers a skewed and uncorroborated view of historic events. For example, the Company provides an misleading chronology of events leading up to the filing in 1999 of a condemnation action against the Company in an effort to argue that the legal expenses incurred in relation to that lawsuit (totaling \$314,353) somehow provided a benefit to ratepayers. (*See Company Closing Brief at 18.*) According to the Company, because during a 1990 election, *nine years earlier*, citizens of Casa Grande voted against condemning the Company’s entire Casa Grande water system, Casa Grande’s 1999 attempt to condemn a portion of the Company’s Casa Grande water

system was similarly against “the will of [Casa Grande] citizens.” (*Id.*) Given the length of time that elapsed between the 1990 vote and the 1999 action, and the different geographic areas implicated, there is simply no way to tell what the citizens of Casa Grande thought about the City’s efforts in 1999. The “people” were perhaps ardently in favor of a fully-integrated municipal water company.

Obviously, there are many problems with the “evidence” proffered by the Company, not the least of which is that there is nothing in the record to support the Company’s speculation concerning the will of the people in 1999. More importantly, however, even if the Company’s theory was supported by evidence, this still does not mean that the Company’s legal opposition to the condemnation provided benefits to ratepayers.

The Company essentially argues that the City’s partial condemnation would have harmed ratepayers by raising costs and leaving ratepayers with less reliable or no water service. (*See* Company Closing Brief at 19.) Yet, when one looks for evidence to support this assertion, there is nothing to be found but unsupported suppositions of the Company President. (*Id.*) Such speculation is not “substantial evidence” sufficient to meet the Company’s burden for recovering legal expenses. (*In re the Petition of Interstate Power Co.*, 416 N.W. 2d 800, 805 and 810 (Minn. App. 1987).) With no empirical or even suggestive data to support the Company’s argument, it is impossible to see whether or not the Company’s legal expenses associated with the condemnation action would have benefited ratepayers.⁵

⁵ There are many factors to consider and the cost of the condemnation action is just one of those factors. Applicable taxes, depreciation rates, bonding rates etc. would impact the rates charged by a public versus a private utility. The net benefit (or detriment) to ratepayers resulting from a condemnation action cannot be known without a careful examination of all of these factors. Similarly, the Company’s assertion that opposition to the condemnation benefited the ratepayers by preventing the “unlawful exercise of government power” is too speculative, especially in the circumstances of this lawsuit, where the governing “statutes and prior case law

The Company's "evidence" supporting its claim for \$453,101 in legal expenses associated with the effluent litigation is even less compelling. According to the Company, the effluent litigation was all about the ratepayers. (See Company Closing Brief at 19.) Nothing could be further from the truth. The record makes clear that this litigation had nothing to do with benefiting ratepayers. Rather, it was an effort by the Company to boost water sales revenue and increase shareholder profits by trying to eliminate competition – without regard to impact upon ratepayers or the long-term effect on limited water resources. (See City Closing Brief at 17-18.)

In summary, under the applicable legal standard, the Company has not offered evidence sufficient to support its claim for recovery of the litigation expenses at issue.

III. Additional Issues

While the City intervened to address its primary concerns – water resource planning, CAP M&I recovery, and litigation expenses – many other issues were raised in the Application and at the hearing. Brief responses to the Company's Closing Brief on these issues follow.

A. Cost of Capital

The City agrees that the Company has a legitimate profit motive and should be fairly compensated for the water services it provides, as well as be encouraged to make necessary and well-planned improvements to the water delivery system. However, the City believes that by employing flawed methodology, the Company has inaccurately calculated its cost of common equity, thereby resulting in an inaccurate cost of capital.

are not a model of clarity," (See Exhibit R-6 at 2 (November 15, 1999 Order)), and the Court's decision on the merits "was a close call." (See Exhibit 3 to the City's Closing Brief at 2, (May 11, 2000 Order).) There is simply no way to know how the condemnation action would have eventually played out in terms of cost or outcome.

The table which follows summarizes Staff, RUCO, and the Company's recommendations for cost of common equity in the most recent rate cases for each of the Company's three service groups:

Cost of Common Equity	Staff Recommendation	RUCO Recommendation	Company Recommendation	Ordered Rate
Western Group (05)	9.2	9.44	11.25	
Eastern Group (04)	9.2	9.18	12.4	9.2
Northern Group (01)	10.25	10.03	12.9	10.25

The table makes clear that the Company has a history of recommending a cost of equity that is considerably higher than the cost of equity recommended by staff, or previously ordered by the Commission. This higher cost of capital is derived from assumptions and calculations previously rejected by Commission Staff. The Commission should likewise reject the Company's proposed cost of capital in this rate case. Because Staff and RUCO's closing briefs provided detailed analysis of the Company's calculations,⁶ the City limits this reply to addressing why the Company's arguments in favor of a risk premium are not persuasive.

1. Several Factors Decrease the Risk Associated with Investing in Arizona Water Company

The Company's Closing Brief makes much of a few "special risks" that allegedly make the Company more risky than the utilities in the sample group, but neglects to address the numerous factors present which decrease the risk associated with investing in the Company. These factors, which include, by way of example, a proposed capital structure that is less leveraged than the sample water utilities, the anticipated dramatic growth in product sales, and the diversification of Company assets, all must be considered when determining whether to apply

⁶ (See Staff Closing Brief at 12-17 (explaining why the CAPM model, using spot prices and intermediate term treasuries, should be used to calculate the cost of common equity over the Company's recommended methods, as well as addressing flaws with the Company's growth estimates); RUCO Closing Brief at 17-18.)

a risk premium. Yet, the Company fails to even mention any of these factors when discussing the proposed risk premium. Because these factors decrease risk, even if the Company were subject to the alleged “special risks,” a risk premium would be inappropriate.

2. The Company Is Not Subject to Any “Special Risks” Justifying a Risk Premium.

None of the Company’s four alleged “special risks” asserted by the Company are justified. First, that the Company is subject to Arizona’s rate-setting system does not create special risk. The authorities cited by the Company addresses situations where a state’s rate-setting system has a history of “arbitrarily switch[ing] back and forth between methodologies,” *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 314-15 (1989), or “not providing adequate returns and/or if it does not provide the utility with the opportunity to earn a fair rate of return,” Roger A. Morin, *Regulatory Finance: Utilities’ Cost of Capital*, 38-39 (1994). The Company presents no evidence (indeed it cannot) that Arizona’s rate setting system has such a history.⁷ Similarly, the Company’s reliance on the use of a historic test year to support its request is flawed. As the Commission already concluded in the most recent rate case for the Company’s Eastern Group, “there is no precedent for recognizing a risk adjustment because the law requires an historical test year.” (Eastern Group Opinion and Order at 23.) This is because, contrary to how the Company attempts to portray the process, the Commission frequently allows the inclusion of post-test year plant in rate base, (*see id.* (noting that a full 12 months of post test year plant would be allowed, and it is “the Company that controls the timing of its rate application and the

⁷ The Company attempts to create the impression that Arizona’s rate setting system is arbitrary and unfair by quoting, out of context, the testimony of Mr. Carlson. (*See* Company’s Closing Brief at 49-50.) Read in context, Mr. Carlson testified that, because utility companies “keep asking for things that were denied before,” over time, “just like [the] legislature, they find . . . they tend to get them.” (Tr. at 1251.) Such evolution of policy and procedure in response to pressure from the utility companies themselves is not the sort of risk contemplated by the Court in *Duquesne Light Co. v. Barasch*, 488 U.S. at 299, 314-15 (1989).

test year.” (*Id.*; *see also* Tr. at 1251 (Testimony of Mr. Carlson) (noting that post test year plant is frequently included in test year).)

Second, the elimination of the Company’s purchased power and purchased water adjustor mechanisms does not create any special risks because the evidence shows that the Company’s power and water costs are not volatile. (*See* Staff Closing Brief at 2-3.) With this history, there is little risk that the Company will be unexpectedly saddled with sudden cost increases beyond its control. Rather, there is every reason to believe that these cost adjusters have actually been impeding the Company from shopping for better prices and, once they are removed, the Company will likely be able to find and utilize lower cost alternatives. (*Id.*) Further, the Company offers no evidence that any of the sample utilities have such adjusters in place.

Third, the new federal arsenic standards create no special risk for the Company, as these standards apply uniformly to all water companies and the Commission has already mitigated the Company’s risk by “approval in both the Northern Group case . . . and [the Eastern Group case], of an arsenic cost recovery mechanism that enables the Company to seek expedited approval of capital costs and a significant portion of operating costs associated with arsenic treatment for its affected systems.” (Eastern Group Opinion and Order at 23-24.⁸)

Fourth, the Company offers nothing but unsupported speculation that using an inverted rate design creates a special risk. The Commission has used such a design in numerous other rate cases, without ever having allowed an associated risk premium adjustment. *See infra* at

⁸ The Company’s Closing Brief argues that the Company’s small size and limited access to capital markets should be considered because they “increase [the risk associated with the new federal arsenic standards].” (Company’s Closing Brief at 58.) However, the Commission has already twice rejected any risk premium based on these factors, as “at least one study supports rejection of allowing a risk premium based on a company’s smaller size.” (Eastern Group Opinion and Order at 23; *see also* Northern Group Opinion and Order at 18-19 (rejecting argument for risk premium based on alleged limited access to the capital markets).)

III(B). Further, this form of rate design is common, with about one third of the utilities listed in the WIFA database employing inverted block rate structures. (Direct Testimony of Edward Harvey at 6.) Therefore, even if it did create risk (and nothing suggests that it does) there is no reason to consider it a “special risk” unique to the Company.

Finally, the Company points to its most recent bond issue to support its request for a risk premium. However, the differences in interest rates between the AWC bonds and other bonds can be attributed to a host of variables, including company management, the bond issue terms, credit market experience, and the underlying asset pledged. Among the numerous considerations which determine the interest rate of a single company issuing a bond at a single point in time, a risk premium applicable in this case simply cannot be ferreted out.

B. Implementing a Multi-Tiered Rate Design Promotes Commission Policy

The Commission has, in recent years, repeatedly and unequivocally rejected single-tiered rate designs in favor of a three-tiered rate design. The Commission should not, as the Company advocates, backtrack from its recent holdings; instead, it should implement Staff’s proposed rate design. Use of an inverted block rate design promotes the Commission’s policy of encouraging conservation by sending the proper price signal. The Company’s suggested alternative, a single-tiered rate design which was flawed in its derivation, does not.

C. An Elasticity Adjustment Is Not Warranted At This Time

The Company argues that if a multi-tiered rate design is adopted, it should be granted an elasticity adjustment. As Staff has already noted, the Commission has never approved such an adjustment and this is not the case to start. (See Staff Closing Brief at 4-6.) The “evidence” cited by the Company to support its request is outdated and highly speculative. (See *Id.*) Further, the factors determining elasticity in each system have not been addressed by any

party. Without isolating and accounting for the factors which determine elasticity, such as the customer mix, it is impossible to forecast the elasticity response with any degree of confidence. Under these circumstances, the Company's proposed elasticity adjustment is not "known and measurable" and must be rejected.

D. The Purchase Power and Water Adjustment Mechanisms Should be Eliminated

The City continues to support Staff and RUCO's position that the Company's purchase power and water adjustment mechanisms should be eliminated. Contrary to the Company's arguments otherwise, neither is appropriate, as evidenced by the Commission's decision to eliminate both adjusters in the Eastern Group. (*See Eastern Group Opinion and Order at 13.*) Here, like in the Eastern Group, the record does not suggest that either purchase power or water costs are a significant portion of the Company's expenses or that these costs are particularly volatile. (*See Staff Closing Brief at 2-4.*) Therefore, they should both be eliminated. (*See generally Michael Schmidt, Automatic Adjustment Clauses: Theory and Application (Exhibit S-17) at 123-24.*)

While the Company argues that continuing the adjusters might benefit ratepayers in certain circumstances, such as allowing rates to decrease when the cost of water or power decreases, it neglects to address the primary problem such adjusters create: They leave the Company with a "disincentive . . . to obtain the lowest possible cost commodity because the costs are simply passed through to ratepayers." (*Eastern Group Opinion and Order at 13.*) This problem is graphically illustrated by the Company's own witnesses admitting that the Company has made no demonstrable effort to procure alternative, lower cost sources of power or water. (*See Tr. at 628-30.*) Therefore, the very situation hypothesized by the Company needed for the adjusters to provide a benefit to ratepayers, is one that the continued existence of the adjusters

renders unlikely to happen. It is likely for this reason that such arguments, raised by the Company in a prior rate case and rejected by the Commission then should again be rejected in this rate case. (*See generally* Eastern Group Opinion and Order at 13-14.)

CONCLUSION

Developing a WRMP, openly with full and timely input from all affected parties will contribute to the Arizona Water Company's success during the coming transitional years, a goal publicly embraced and promoted by the City of Casa Grande. For this reason, the City asks that any CAP M&I capital expense recovery be contingent upon the submission of a WRMP as described in Exhibit CCG-7. Because the Company has failed to carry its burden to justify inclusion of certain non-recurring litigation expenses in rate base, the City joins Staff and RUCO in opposing recovery of these charges.

Respectfully submitted this 22nd day of August, 2005.

OSBORN MALEDON, P.A.

By Joan S. Burke
Joan S. Burke
Danielle Janitch
2929 North Central Avenue, Suite 2100
Phoenix, Arizona 85012-2794
(602) 640-9356
jburke@omlaw.com

Attorneys for the City of Casa Grande

1052521.2

Original and thirteen (13) copies of
the foregoing were filed this 22nd day of
August, 2005, with:

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

Copies of the foregoing mailed this
22nd day of August, 2005, to:

Robert W. Geake
Vice President and General Counsel
Arizona Water Company
P. O. Box 29006
Phoenix, Arizona 85038-9006

Norman D. James
Jay L. Shapiro
3003 North Central Avenue
Suite 2600
Phoenix, Arizona 85012
Attorneys for Arizona Water Company

Daniel W. Pozefsky
Residential Utility Consumer Office
1110 West Washington Street, Suite 220
Phoenix, Arizona 85007-0001

Jeffrey W. Crockett
Deborah R. Scott
Snell & Wilmer
One Arizona Center
400 East Van Buren
Phoenix, Arizona 85004-2202
Attorneys for Pivotal Group, Inc.

Marvin S. Cohen
Sacks Tierney, P.A.
4230 North Drinkwater Boulevard, 4th Floor
Scottsdale, Arizona 85251

Teena Wolfe
Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

A handwritten signature in cursive script, appearing to read "Ellen Bruce", is written over a horizontal line.

1052521.2